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The Development and the Performance of the Egyptian Income Tax System

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by

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C O N T E N T S

INTRODUCTION.

Income Taxation is new in Egypt. The introduction of income taxation in 1939 was aimed at achieving two basic objectives; first, to raise revenue to meet the steady increase in public expenditures, and secondly, to establish an element of equity in the tax system, where indirect taxation, which is regressive in nature, predominates. The main object of this study is to analyse the competence of the income tax system in attaining these objectives.

Before starting our enquiry into the performance of the income tax system it seems desirable to present at the outset the background of the Egyptian economy within which the income tax operates. Part I of this study deals with the economic background and gives a brief account of the evolution of the Egyptian tax system. Until the early 1950's fiscal policy was based on what is called "sound finance". Income taxation was used mainly to achieve a balanced budget by providing the Treasury with revenue to meet the increase in public expenditure. This classical attitude was changed after 1952, when a policy based on "functional finance", was attempted. In general, public policy was directed primarily towards the acceleration of the rate of economic growth. Investment in the private sector has proved relatively inadequate for economic growth. As the data in Chapter I show, there has been a continuous decline in private investment, and the public sector, therefore, had to replace the decline in private investment. The result was a continuous rise in public investment, financed basically through deficit financing. By and large, the dependence on income taxation to reach economic objectives has been relatively unsatisfactory by virtue of the fact that the scope of its application is very limited due to the persistence of a subsistence economy, which implies a low income per capita.

Our enquiry into the performance of the income tax system pertains to the discussion of the various objectives of the tax. Any income tax system has to be judged according to three main criteria; first, its adequacy as a revenue-raiser; secondly, its efficiency in establishing equity in the distribution of the fiscal burden, and thirdly, the economic efficiency of the tax judged by its impact on incentives, e.g. incentives to work, to save, and to invest, besides its role as an economic stabilizer.

The attainment of any one of public policy objectives produces a conflict with other objectives. For example, to achieve equity in income taxation a high exemption limit which coincides with the general necessities of the population has to be provided in the system. This provision, when applied to less-developed countries, implies the exemption of the major part of the population and hence reduces the tax revenue. Actually, the introduction of full or partial exemptions (a reduced rate on earned income for example) may be equitable; they render the tax less efficient as a revenue-yielder. In the meantime, to achieve equity through introducing a highly progressive income tax may have a disincentive effect on the economy and, therefore, the economic efficiency of the tax is by-passed. A compromise has, however, to be reached. But any compromise reached would include a partial sacrifice of one of the objectives in favour of the others. In general, the compromise which should be reached is usually based on the main objectives of the Government fiscal policy.

Part II discusses the performance of the Egyptian income tax system. The procedure of the investigation followed throughout this part is to judge whether the tax has reached its objectives or not, and is divided into three categories. The discussion starts with a brief analysis of the theoretical background of the existing theories relating to the basic aims of any income tax system, followed by its application within less-developed countries and, finally, its application to the Egyptian system. To be more precise, the Egyptian system is judged throughout this part on its merits and demerits in the light of the latest theories of public finance.

The first section, Chapter 3, is devoted to efficiency of the income tax as a revenue-raiser. The efficiency of the tax as a revenue-yielder depends on various and diversigied factors. These factors are of four main c ategories, all of which could easily be interdependent; they are, (1) factors related basically to administrative efficiency; (2) the degree of tax consciousness; (3) the degree of illiteracy and book-keeping; and, (4) the degree of tax evasion. In most less-developed countries the inefficiency of the income tax as a revenue-raiser originates mainly from the inadequacy and inefficiency of the above mentioned factors.

A badly administered tax, though equitable, would prove more harmful than a partially inequitable tax with an efficient administrative machine. The flexibility of the tax and its competency as an economic stabilizer is usually hampered by administration and the low standard of tax morality which exists between taxpayers, particularly in backward countries.

The second section, Chapter 4, is concerned with the question of the equity of the tax and how far the system has reached this objective. It is quite conceivable that a more extensive use of income taxation within the fiscal system introduces a higher degree of equity into the tax system as a whole. In less-developed countries where the over-all tax burden is inclined to be regressive as a result of the great dependence on indirect taxes, income taxation, as the most effective and personalized direct tax, could serve as an element of equity within the tax system.

Equity in taxation has been widely discussed by many economists as well as politicians. In popular discussion of the equity concept the fairness in the distribution of the tax burden is usually regarded as an important, if not the outstanding, test of the fiscal system, and its ability to inspire that confidence in the fiscal basis of goverment sustains public morale and promotes productive effort and e conomic growth. An elementary application of the equity concept requires the equal treatment of persons in similar economic circumstances. But the economic position and circumstances of individuals vary widely, and the range of equity secured by the applic tion of the concept is, therefore, not very wide in its operation. Now the most commonly accepted applic tion of the criterion of equity is found in the principle of levying taxes according to relative 'ability to pay'. 'Ability to pay' includes and necessitates some degree of progressiveness in the tax rate if fairness in relative treatment of persons with unequal incomes is to be achieved. No formula underlying the scale of progression/is considered equitable regarding the distribution of the tax burden, as any scale may include ultimately an element of arbitrariness which in turn would render the tax less equitable.

However, our discussion of the equity principle in relation to the Egyptian income tax system is confined to two major concepts; first, horizontal equity, i.e. the equal treatment of equals and the f ctors affecting it, such as the definition of taxable income, personal exemptions and reliefs required to attain more equitable treatment of the individuals enjoying the same income but having different personal and other obligations. The question of personal exemptions and other reliefs is closely related to this concept. Equity, however, is achieved through the functioning of personal reliefs. This supports the introduction of personal reliefs and the exemption of subsistence income from taxation, and defeats the out-dated allegation that exemptions are a deviation from equity doctrine. The second concept of equity is the vertical equity, i.e. the unequal treatment of persons in unequal economic situations; this necessitates progressiveness in the rate structure.

Income taxation may affect the functioning of the economy. Firstly, it alters the supply of the factors of production and secondly, it may alter the decisions of business firms and thus the demand for these factors. By and large, both effects will alter the level of national income, its composition and its distribution. In other words, through its effects on the national income the tax may have a considerable effect on theeconomic incentives which are of great importance for economic development. In a less-developed economy like the Egyptian one, we believe that the anlaysis of the effects of the income tax on the basic economic aspects which are related directly to economic development should receive the lion's share of the analysis. Therefore, it is both desirable and fruitful to discuss the impact of the income tax on; (a) the incentive to work, (b) the incentive to save, and (c) the incentive to invest.

By the end of Chapter V; the end of the enquiry into the effect of the Egyptian system on the various incentives, we have not in fact reached the final stage of our enquiry into the development and the performance of the Egyptian income tax system. We must, in addition, consider the role of income tax exemptions in the system. This is of special significance, as they affect directly the degree of achievement of the tax objectives. Liability to tax is the rule and exemptions are the exception. Therefore, exemptions, partial or complete, affect the size of the tax base and hence the amount of revenue raised. The principle of equity could on the one hand, be achieved and on the other violated through exemptions. This in fact depends on the ultimate aims of public policy. Personal and business exemptions, however, are needed to accomplish economic objectives, such as being used as an inducement to save and invest. Income taxation has also been recommended as a stabilizer through the use of various exemptions and reliefs. In general, exemptions and reliefs, either personal or business, are considered the principal tools on which the income tax depends to perform its task in the ecnomic and social framework of the country. For this reason we devote a special part of this analysis, before concluding our investigation into the performance of the Egyptian income tax, to a discussion and analysis of the role of the exemptions and reliefs within the Egyptian income tax. This will be the subject of Chapters VI and VII. Chapter VI deals with the main objectives which income tax exemptions and the various reliefs are primarily designed to accomplish. Chapter VII deals with a special problem of income tax exemptions, the problem of double taxation in regard to its dual sections, domestic and international. The discussion of the role of exemptions in the income tax system concludes Part II on the performance of the Egyptian income tax.

Particular conclusions are set out in the course of the study whenever this appears appropriate. However, it does seem valuable and systematic to conclude our research by pointing out the main reforms which seem adequate to make the Egyptian income tax more effective in adeveloping economy. The pathway to reforms, Chapter VIII, which is our conclusion, is divided into two main sections; first, reforms for the immediate future, and secondly, reforms for a long term application.

This study of the Egyptian income tax system elucidates the actual working of the system in the Egyptian economy. The writer found great difficulty in obtaining data concerning the Egyptian income tax, but we have made use of almost all the available data to present our study on a practical basis, backed by sound and modern public finance theories.

P A R T I.

B A C K G R O U N D

PART I.

BACKGROUND

The main purpose of this part is to indicate the background of the Egyptian economy where the income tax system operates. This background is essential, as the study of any aspect of the fiscal system necessitates the knowledge of the environment within which the system stands. As our main object of this study is concerned with economic policy, social and political policies are considered only in so far as these policies affect the functioning of the economic organisation of the country.

The first section of this part (Chapter I) gives a descriptive analysis of the Egyptian economy from three main aspects: (a) the composition and distribution of the national product; (b) the structureof public finance, and (c) the main basis on which Egyptian fiscal policy has been established.

The second section (Chapter II) is devoted to the evolution of the Egyptian income tax. The main aim here is to elaborate the historical development of the tax system in general and the income tax in particular. In addition, this Chapter sheds some light on the objectives which the income tax system was designed to accomplish.

Generally the main object of Chapter I is to bring out the basic characteristics of the Egyptian economy as a whole, and to separate the various components of public policy from one another. The factors composing the national economy are, however, interdependent, and it is difficult, if not impossible, to separate one factor from the other. On the other hand, the discussion in Chapter II is essentially confined to the tax system - the revenue side of the Budget - and the income tax in particular. In other words, the evolution of the income tax within the framework of the tax system is the main theme of Chapter II.

In the Appendix to Part I, the structure of the present main taxes on income is outlined.

By and large the purpose of the analysis in this part is to acquaint the reader with the fundamentals on which the Egyptian fiscal system is established.

CHAPTER I.

THE SETTING AND STRUCTURE OF THE EGYPTIAN ECONOMY.

Egypt's main economic policy, especially in the post-war period, has been the struggle to maintain at least, if not to raise, the standard of living in the face of rapidly growing population. Since the last century the population of Egypt has been increasing at an average annual rate of over 20 per thousand. (The present population is estimated to be about 24 million (1958). Economic growth accompanied by this population increase has come about mainly through the expansion of the cultivated area. Economic development up to the first quarter of the present century was based on cotton, the output of which increased several fold and correspondingly it resulted in the increase of exports.[1]

A marked slowing down of economic expansion was witnessed afterwards while the population continued to grow at a high rate.[2] The struggle to increase the cultivated area proved difficult due to the shortage of capital. Therefore, the cultivated area was fixed while soil exhaustion during the period of World War II decreased the net agricultural output which was not adequately offset by the expansion of industry which proceeded during the Second World War.

Post-war Egyptian economic policy supported the expansion of cultivated areas, the diversification of agricultural production, the expansion of industry,

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1. Cotton output during the last decade of the 19th century amounted to an average of 110 thousand metric tons and reached 373 thousand in 1957. See, U.N., Statistical Year Books, (1949-1958).

2. U.N., Economic Developments in the Middle East, 1945-54, 1954-55, and 1955-56.

TABLE I

The Situation of Agricultural Tenure in 1956

Size of Tenure	Number of owners	Total Land (Feddan)	Average per Owner	Size of Tenure	Number of Owners	Total Land (Feddan)	Average per Owner
less than 1 feddan	2,122,978	819,965	0.39	30 fedd. to 50 fedd.	9,416	350,819	37.26
1 fedd. to 5 "	660,061	1,431,687	2.17	50 " " 100	7,106	479,405	67.5
5 " " 10 "	81,036	532,205	6.57	100 " " 200	3,341	450,493	134.8
10 " " 20 "	48,547	650,192	13.39	over 200	1,742	936,514	537.6
20 " " 30 "	13,909	325,072	23.37	Aggregates	2,948,136	5,876,252	

(one Feddan equals 1.038 acres)

Source: Statistical Pocket Year-Book, Republic of Egypt, 1957.

together with increasing financial autonomy of the country and an improved fiscal system.[1] The effectiveness of the Government's efforts within the economic field before 1952 proved inadequate. Since 1952 a systematic drive for economic development was launched and an attempt to redistribute wealth and income was incorporated through the Land Reform Act of 1952.

A. <u>Composition and Distribution of the National Product.</u>

Egypt, like most underdeveloped countries, is dependent primarily upon agriculture. Egyptian agriculture is characterised markedly by a dependence on one major crop for export, i.e. Cotton; employing a labour intensive technique; and unequal distribution of property accompanied by very small-scale tenure and farming.[2] Cotton output increased several fold since the 19th century due to the large-scale irrigation works constructed. Exports of cotton rose correspondingly from 141,000 metric tons in 1870 to 412,000 in 1934 and then dropped to 288,000 metric tons in 1954 due to the decrease in output resulting from the limitation of area cultivated.[3]

The dependence on a single crop for export, i.e. Cotton, has always resulted in sharp fluctuations in the balance of payments and thus on the economy as a whole. This has been due to the fact that cotton prices which fluctuate in the world market are beyond Egypt's control. Needless to say, any change in cotton prices and hence,

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1. C. P. Issawi, Egypt at Mid-Century, London, 1954 pp. 240-245.

2. The Land Reform of 1952 helped to a certain extent to equalise the distribution of agricultural property. See Table 1 for the latest available data concerning the distribution of the agriculture tenure.

3. U.N., <u>Economic Developments in the Middle East</u>, 1945-54 pp. 25-31

in the amount exported is immediately reflected in the net national income. The increase in cotton prices and in exports is translated into an increase in producers' incomes and traders. On the other hand, the surplus in the balance of payments would tend to increase domestic consumption. This increase usually leads to an increase in prices of domestic products as the supply lags behind the increase in demand. However, the increase in demand could be offset by an increase in imports. While this may be the case in a free economy, it is of a limited existence in Egypt as the Government intervenes by restricting imports and imposing limitations on the foreign exchange. Generally speaking, therefore, any increase in the cotton prices results in a direct increase in prices of other commodities; it creates a temporary inflationary trend which, in most times, is only offset by a fall in international cotton prices.

Consequently, external factors play a fundamental role in the Egyptian economy due to this dependence on one cash crop. As a solution to this situation a diversification of the economy has to take place.[1]

From Table 2 (Net National Product for 1950 to 1954), the agriculture sector is the main sector in the Egyptian economy; as it constitutes a proportion varying from 45% in 1950 to a minimum of 34% in 1953. The value of agricultural production depends on two variables, (a) the quantity of the crops which depend mainly on natural factors beyond human control; (b) the prices of products especially Cotton.[2] Generally, the fluctuations in the value of the agricultural sector is usually caused by the fluctuations of the cotton prices as the total area cultivated is almost constant for

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1. For an excellent survey of the agricultural production in general, and of Cotton in particular, see G. M. Said, Egyptian Economics, Cairo, 1951 (in Arabic).

2. The value of the cotton crop in 1950, for example, was £E213.4 million out of £E314.1 million total value of agricultural products, i.e. 68%

TABLE 2

Net National Produce at Factor Cost (Current Prices)

1950 to 1954 @

Sector	1950		1951		1952		1953		1954	
	£Em.	%	£Em.	%	£Em.	%	£Em.	%	£Em.	%
1. Agriculture, Forestry and fishing	353.0	45.0	347.0	40.3	269.0	35.9	272.8	34.9	310.2	35.7
2. Mining and quarrying	2.4	0.3	2.5	0.3	2.9	0.4	3.2	0.4	7.2	0.8
3. Manufacturing	66.5	8.4	71.5	8.3	65.1	8.7	76.8	9.8	93.3	10.7
4. Construction	25.1	3.1	25.1	3.0	25.1	3.3	20.3	2.7	25.4	2.8
5. Electricity, gas and water	2.0	0.3	2.2	0.3	2.4	0.4	2.8	0.4	4.7	0.5
6. Transportation and storage	51.1	6.4	58.8	6.5	53.5	7.2	55.0	7.1	58.0	6.7
7. Wholesale and retain trade	56.7	7.2	67.1	7.9	54.0	7.2	59.7	7.6	69.4	8.0
8. Banking, insurance and real estate	15.0	1.9	25.4	2.9	18.1	2.4	15.2	2.0	16.7	1.9
9. Ownership of dwellings	46.4	5.9	54.4	6.4	59.2	7.9	56.5	7.2	62.5	7.1
10. Public Administration and defence	95.2	12.0	112.5	13.1	124.1	16.6	128.7	16.5	141.4	16.3
11. Services	87.2	11.0	106.4	12.4	86.8	11.6	97.0	12.4	91.8	10.6
Net domestic product at factor cost	800.6	-	872.9	-	760.2	-	788.0	-	880.6	-
Net factor income from rest of the World	-11.2	-1.4	-12.5	-1.4	-12.1	-1.6	-7.8	-1.0	-13.1	-1.5
Net national product at F.C. = national income	794.9	100	860.4	100	748.1	100	780.2	100	867.5	100

@ Official published estimates for years after 1954 are not available

Source: U.N., Statistics of National Income and Expenditure, New York, 1957, p. 85.

the last thirty years and now stands at just over six million feddans (one feddan equals 1.038 acres).[1]

While the significance of the agricultural sector as measured by its proportion of net national product is decreasing, we find that the importance of the industrial sector is increasing slowly but gradually; from 11.8% in 1950 to 14.3% in 1954. The relative importance of the Government sector has increased since 1950; from 12% to 16.3% in 1954. The policy of the Government since 1952 is to stimulate industrialisation by all available means. Restrictions were imposed through foreign exchange control on imports of manufactured goods which could be produced locally. Domestic manufactured goods also received protection through higher tariffs on imports, while the imports of raw material and machinery were granted exemptions from, or reductions in, Customs duties. In addition, income tax exemptions were granted to new enterprises during their first few years of operation. The Government participated in furnishing the capital of major industrial enterprises. Moreover, industrial credits were increased mainly through the Industrial Banks.

By and large, industrial production in Egypt has increased considerably since 1950; the industrial production index increased from 105 in 1951 (1950 = 100) to 133 in 1955.[2] The upward trend of the industrial output is almost certainly due to the increase in industrial investment.

As a consequence of the predominance of the agricultural production, the economy is heavily dependent upon imports as a source of manufactured consumers' and producers' goods. The importance of foreign trade is in turn reflected in the relatively large

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1. C. P. Issawi, op. cit., p. 102; and also see Statistical Pocket Year Book, 1954, Republic of Egypt, p. 33.

2. U.N., Economic Development in the Middle East, 1956-57, p. 129

TABLE 3

Sources and Use of Resources at Current Prices.

£Emillions.

Item	1950	1951	1952	1953	1954	1955	1956
I. Sources							
(a) Domestic Production	819	887	839	878	975	1033	1052
(b) Net Import Surplus	-1	81	34	0	-6	-4	13
Total Resources	818	968	873	878	969	1029	1065
II Uses							
i) Private Consumption	630	760	693	697	763	832	885
ii) Government Consumption	73	65	64	65	71	75	70
(a) Total Consumption	703	825	757	762	834	907	955
i) Private Investment	112	103	83	64	57	54	39
ii) Public Investment	22	29	25	34	53	62	66
iii) Changes in Stocks	-19	11	8	18	25	6	5
(b) Total Investment	115	143	116	116	135	122	110

Source: National Planning Commission, Office of the Secretary General, Published by the U.N., in Report on Economic Development in the Middle East, 1956-57, p.7

share of commercial, wholesale and retail trade, and transportation services in the net national product, some 14% to net domestic production.

An over-all picture of the economy is given in the figures on the availability and use of resources compiled in Table 3. The general outlook of the economy is its steady growth since 1950 with the exception of the years 1952 and 1953 which were affected mainly by unstable political conditions.

Since 1950 up to the present time, inflationary pressures generated by government finance have been dampened to a great extent by a decline in gross capital formation and deficits in the balance of payments. Savings activity has considerably increased since the Egyptianization of savings institutions which took place early in 1957.[1]

Estimates of capital formation since 1950 up to 1956 are shown in Table 4. Public investment rose continuously while private investment declined. The increase in public investment accounts was due mostly to the growing Government deficit.[2] Total national investment has declined since 1951; while no data are available at present, one could not preascertain the trend of aggregate domestic investment after 1956. According to the U.N. Report on the Economic Development in the Middle East, 1956/57, it may be presumed that domestic resources under such circumstances, and since consumption seems to have maintained a fairly constant ratio to production, have not been overstrained and that the present scale of total investment does not

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1. The total amount of deposits in Postal Savings Offices reached £E39.4m. at the end of May 1958 as against £E32.6m. in December 1956. Deposits in Government Insurance and Pensions Funds have risen from £E20.7m. at the end of January 1957 to £E32.8m. at the end of May 1958. Savings and other deposits in all banks rose from £E55.4m. at the end of 1956 to £E55.87m. at the end of 1957 to £E61.93m. at the end of January 1958. See, The Budget Report for the Year 1958/59, Southern Region, United Arab Republic, p. 26.

2. U.N., op. cit., p. 13

TABLE 4

Savings and Investments
(at current prices)

£Emillions.

Item	1950	1951	1952	1953	1954	1955	1956
Total Investment	115	143	116	116	135	122	110
Gross Private Investment	112	103	83	64	57	54	39
Gross Public Investment	22	29	25	34	53	62	66
Changes in Stocks	-19	11	8	18	25	6	5
Total Domestic Savings	135	51	74	98	116	120	92
Private Savings	121	68	92	62	66	108	123
Public Savings	14	-17	-18	36	50	12	-31

Source: National Planning Commission, Office of the Secretary General, published by the U.N. Economic Development in the Middle East 1956-57, p. 13.

necessarily lead to inflationary pressure.[1] The decline in the public savings in 1956, or in other words, the dis-saving incurred in the public sector was mainly due to the economic crises resulting from the Suez military operations at the end of 1956.

The very low marginal propensity to save in the private sector; is an apparent characteristic of the Egyptian economy as well as in most less-developed economies.[2] Although domestic production rose steadily, savings, as a percentage of domestic production, declined from its peak of 15% in 1954 to 12% in 1955 and to 9% in 1956 reaching the 1952 level. Various factors could be considered as the causes of the lag in domestic savings behind the growth of domestic production. According to the U.N. Report, previously mentioned, the main cause in the public sector is the sharp increase in the expenditure on defence, education and welfare. In the private sector, the main forces could be attributed to (a) redistribution of the agricultural wealth and income as a result of the Land Reform of 1952; (b) the rise in the price level during the period from 1954 to 1956 which may have distorted the capacity and will to save; (c) the rise in urban wages due to the Government intervention: and (d) lastly, but not least, the increase in domestic product in later years is largely attributable to good harvests and that the resulting increase in income has been enjoyed by the rural community which has an exceptionally high marginal propensity to

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1. Ibid.

2. The marginal propensity to consume was estimated to be very high, about 0.9 and as the marginal propensity to import is about 0.3, therefore, the multiplier would equal $\frac{1}{(1 - 0.9) + 0.3} = 2.5$

   Cf., Fouad Sherif, Monetary Policy in Egypt (in Arabic) p. 24

consume and a very low marginal propensity to save.[1] Generally speaking, aggregate gross investment has not increased since 1954 (up to 1956) in spite of the continuous increase in the Government expenditure on economic development.[2]

B. Public Finance.

(i) Public Receipts and Expenditure:

Our discussion of the Egyptian public finance will be limited by the period during which income taxation was in operation; i.e. since 1939. From 1937/38 to 1949/50, receipts and expenditure of the general budget rose each year. In most of these years, receipts exceeded expenditure, raising the accumulated surplus reserve of the Government to the highest level in the country's history. In spite of the consistent surplus accumulation, the economy experienced a considerable degree of inflation due to the Allied Forces expenditure throughout that period. In later years, from 1950/51 up to 1957/58 the general trend as seen from final accounts and budget estimates shows a continuous deficit which was met by either drawing on the Reserve Fund or through borrowing.[3]

Government revenue increased sharply, in money terms, due to the levy of new taxes in the early forties and to the increase in the existing tax rates especially Customs and Excise. Moreover, the increase in the national income increased personal incomes and profits and thus an increase in income tax revenues was apparent. In general, taxation, direct and indirect, is the major component of the present Egyptian ordinary budgets. On the other hand, public loans cover an important part of the expenditures

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1. Ibid., p. 14

2. No data is available to show the situation of total savings and investment after 1956. But, in general, there is a rise in the trend as Government investment on the Five Year Plan commenced late in 1956.

3. See Table 5 for an overall picture of the Egyptian public receipts and expenditure; nearly all years show a deficit except the year ending 30/6/54 which showed a surplus of £E6.6m. (Statistical Pocket Year Book, 1955, Republic of Egypt).

TABLE 5

Egyptian Budgets, since 1939 to 1958 (selected years)

(Ordinary Budgets)

	1939	1945	1948	1950	1952	1953	1954	1955	1956	1957	1958
Revenue:							E	E	E	E	E
Taxes on Income	0.40	14.74	12.31	18.09	26.69	23.10	20.25	18.25	19.50	24.50	26.35
Succession Duties	-	0.02	0.34			3.25	3.00	3.00	3.00	3.00	2.00
Taxes on Land and Buildings	6.31	5.69	5.02	7.44	14.41	15.00	19.57	19.11	19.14	23.16	24.81
Customs and Excise	19.47	36.06	54.14	95.74	104.85	92.94	96.42	105.75	114.68	115.01	111.04
Other Receipts	11.44	31.22	27.12	37.27	45.59	43.32	37.57	44.63	54.66	86.58	102.35
Total	37.62	87.73	98.93	158.54	191.54	177.61	176.81	190.74	210.98	252.25	266.55
Expenditure:											
Interest on Public Debt	4.19	4.60	3.45	6.07	6.20	4.24	4.56	4.41	4.51	5,40	5.76
Price Subsidies	-	-	3.98	7.11	-	13.43	6.25	1.73	1.92	3.00	2.07
Education	4.53	7.11	11.91	19.02	24.24	21.66	24.61	26.09	28.12	31.10	33.93
Health	2.45	4.79	5.81	8.57	7.17	5.84	6.43	6.97	7.65	8.34	7.82
Social Affairs	-	1.35	1.49	2.41	4.45	2.73	2.86	2.97	3.13	3.23	2.99
Defence	5.0	7.27	8.62	34.39	43.77	36.35	39.28	53.57	55.00	75.39	71.87
Other Current Expenditure	24.22	56.98	59.29	86.24	145.17	78.69	73.40	79.49	86.70	94.81	92.82
New Works	@	@	@	@	@	22.64	17.16	19.85	21.81	28.71	46.03
Total:	40.39	82.10	94.55	163.81	231.0	185.58	174.55	195.08	208.84	249.98	263.99

E = Budget Estimates

@ = New works are £E9.22m of total expenditure in 1939; £E9.07m. in 1945; £E13.13m. in 1948; £E33.51m. in 1950 and £E54.60 in 1951 (estimate).

Source: U.N., Statistical Yearbooks, (various years).

on economic development especially since 1952 when the Government resorted to the policy of deficit financing.

Table 5 shows the amounts of public revenue and public expenditure of the ordinary budget since 1939 up to the fiscal year ending June 1958. Taxes on income and wealth show a gradual increase especially since the end of the war. The same could be said about Customs and Excise as well as property taxes. Other public receipts have also increased, especially in recent years (since 1956), due to many factors, such as; (a) the increase in revenue share of the Government in various industrial establishments due to its expanding policy in stimulating industrialisation through direct participation in equity Capital; (b) the increase in the proceeds of confiscated properties resulting from the Suez crisis later in 1956; and, (c) the increase in the Government's share in the net revenue of the Suez Canal Authority after its nationalisation in 1956.

The expenditure side of the same table shows the sharp increase in expenditures on defence especially after 1954. Expenditure on education shows a continuous steady increase while expenditure on health has been relatively at a constant level during the post-war period up to the present time. Current expenditure to meet current Government activities and administration continued to increase; it was £E31.1m. in 1938/39, about 77% of aggregate public expenditure, and reached £E146.6m. in 1948/49, about 80% of aggregate public expenditure, then it reached its peak in 1958/59 (budget estimates) £E245.6m., or about 91% of total public expenditure of the ordinary budget.[1]

Since expenditure on the ordinary budget does not show total public expenditure, the expenditure estimates of National Development, Public Services and other autonomous budgets must be added to it. These subsidiary autonomous budgets (expenditure side) amounted to £E76m. in 1955; to £E100m. in 1956; and to £E127m. in 1958/59.

1. The Budget Report for the Year 1958/59, Ministry of Treasury, Southern Region, United Arab Republic.

TABLE 6

Ratio of Ordinary Budget to Net Domestic Product

in various selected years.

£Emillions.

Fiscal Year	Net Domestic Product (1)	Public Receipts (2)	Public Expenditure (3)	$\frac{\text{Col. (2)}}{\text{Col. (1)}} \times 100$ (4)	$\frac{\text{Col. (3)}}{\text{Col. (1)}} \times 100$ (5)
1939	157	37.6	40.4	24.1	25.7
1945	449	87.7	82.1	19.5	18.3
1950	789	158.5	163.8	20.0	20.7
1951	860	184.7	190.2	21.5	22.1
1952	748	191.5	231.0	25.6	30.9
1953	780	177.6	185.6	22.7	23.8
1954	867	176.8 E	174.5 E	20.4	20.1
1955	1033	190.7 E	195.0 E	18.5	18.9
1956	1052	211.0 E	208.8 E	20.0	19.8
1957	not available	252.2 E	250.0 E	-	-

E = Budget estimates

Sources: U.N., Statistical Year-Books; Economic Development in the Middle East, 1956-57; and C.P. Issawi, Egypt in MidCentury, London, 1954, p. 83.

Accordingly, from the foregoing information, we find that the Government sector in Egypt is relatively large as a proportion of net domestic product. This fact is of significant importance to the Government as it could, with the aid of a rational fiscal policy, exert considerable pressure upon the price level.[1]

Table 6 shows that the ratio of Government expenditure (ordinary budgets) to net domestic product tended to be fairly constant as it forms about one-fifth of the total domestic expenditure with the exception of the year 1952 when it reached 30.9%. In order to give a non-biased picture of the Government sector as illustrated by its public expenditure, we have to add, as previously mentioned, the expenditure expended on economic development and other activities which are not included in the ordinary budget. Therefore, the ratio of public expenditure to net domestic product increases accordingly; to 26% and to 29% in 1955 and 1956 respectively.

(ii) Public Debt:

Public debt in Egypt has risen steadily, especially during the last decade, since the Government budget policy has changed from the dependence on the Reserve Fund to cover budget deficits to public borrowing.

The most striking change in the public debt structure during the World War II was the conversion and repayment during 1943 of the entire external debt by means of national loans. Since that time the public debt has consisted of domestic obligations only. Domestic debt increased not only by conversion of foreign into domestic obligations, but also by the issue of "Cotton Purchase Financing Loans" and other loans for military purposes, e.g. "Palestine Loan". These loans were issued during the first few years of the post-war period. In order to maintain cotton prices at a reasonable level after the War, the Government was prepared to buy cotton at a higher price than the market price from local growers and merchants. For financing such purchases, Treasury bills of

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1. U.N., Economic Development in the Middle East, 1956-57, p. 9

TABLE 7

Composition of Public Debt at Year End.[1]   £Emillions.

Item	1940	1946	1951	1952	1953	1954	1955	1956	1957	1958[2]
National Loans[3]	91.6	86.0	78.0	78.0	78.0	78.0	78.0	78.0	78.0	78.0
Cotton Loan	-	6.0	-	15.0	15.0	-	-	-	-	-
Palastine Loan	-	-	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Agrarian Reform Bonds	-	-	-	-	-	12.5	14.6	16.7	22.3	26.0
Development Loans	-	-	-	-	-	-	25.0	50.0	50.0	50.0
Miscellaneous	1.6	1.3	-	-	-	-	-	-	-	-
Total Loans in Bonds	93.2	93.3	108.0	123.0	123.0	135.5	147.6	174.7	180.3	184.0
Treasury Bills	-	-	35.0	50.0	49.5	38.0	71.0	146.0	150.0	150.0
Total:	93.2	93.3	143.0	173.0	172.5	173.5	218.6	320.7	330.3	334.0

1. This table excludes Treasury Bills issued for the purpose of covering the note issue.

2. At the end of April 1958.

3. Before 1943 National Loan replaced the Foreign Debt.

Sources: U.N. Public Finance Information Papers, Egypt, 1950;
U.N. Economic Development of the Middle East, 1956-57; and
The Budget Report for the year 1958-59, Southern Region, United Arab Republic.

£E12 millions and a "Cotton Purchase Loan" of £E30m. were issued in 1946. In the same year Treasury bills of £E30m. were issued to cover additional note issue of the National Bank of Egypt for financing the cotton crop. In 1952, legislation was passed authorising another issue of 3 months bills up to a limit of £E50m. This limit was raised in 1954 to £E60m., and in 1955 to £E150m.[1] Before 1955 Treasury bills were used only to finance the cotton transactions of the Government, but since 1955 they have been used for financing the Government's general activities.[2]

Table 7 shows the changes in the components of the public debt since 1940. The increase of public debt during the last four years was due to the reliance of the Government on deficit financing in implementing a considerable part of development plans and also to finance part of other current activities which current receipts have failed to meet. Almost four-fifths of the public debt in recent years (since 1955) has been financed by the banking system particularly the Central Bank, which absorbed two-thirds.[3]

C. Fiscal Policy.[4]

The objectives of the Egyptian Government finance can be summarised as follows:-

1) The maintenance of the basic machinery of government and the procurement of such services as governments generally provide for the citizens of their countries;

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1. According the Law No. 242 of 1955, the Minister of Finance was authorised to increase the amount of Treasury bills issued to £E200m. after the consent of the Cabinet.

2. U.N., op. cit., p. 11

3. Ibid.

4. The analysis of the Egyptian Government fiscal policy has to be very brief as our aim is only to pave the way for further analysis regarding the economic efficiency of the income tax (Chapter 5).

2) The promotion of economic development, either by direct government action, such as the construction of highways, bridges, etc., or directly through the combined effect of taxation and expenditures on the economic system.

3) The improvement of social and cultural conditions, including not only specific purposes like education and public health, but also broad social objectives, such as the distribution of income that will ensure a balanced growth of the economy. These goals may be pursued through both tax policy and through expenditure policy. Besides fiscal measures other devices have been taken to redistribute wealth and income especially in the agricultural sector through the Land Reform of 1952 which limited the ownership of cultivable land by 200 feddans (one feddan = 1.038 acres);

4) One of the fundamental objectives of any sound fiscal policy is to maintain a high degree of economic stability in so far as possible, and compensation for fluctuations in general business activities aiming at the conservation of a high degree of employment. This may be accomplished through the adaption of taxation to changing economic conditions and through public works.

Egyptian fiscal policy in practice had not aimed primarily up to the present time, at stabilizing the economy but its main objective has been to maintain the basic government machinery. In this context the principal aim of any Minister of Finance has always been to find the necessary funds to cover the current public expenditures. Economic and social development, especially the economic development of the industrial sector received little attention, while the agricultural sector received a great deal of attention due to the political influence of landlords. Most government expenditure on economic development was expended on irrigation schemes. In general, all Ministers of Finance used to follow the classical attitude of keeping a balanced budget in preserving a sufficient reserve fund to be used in case of emergencies if final accounts showed any deficit.

Deficit financing through public borrowing has been developed in the 1950's and particularly after the 1952 Revolution when the Government was faced with major economic difficulties due to the enormous decline in cotton prices and exports. Since 1955 the Government resorted to public borrowing to finance economic and social development programmes (see Table 7).[1] Before the 1952 Revolution, public borrowing was only resorted to in cases of emergency, e.g. Palestinian expenditure, or to finance the cotton crop.

Taxation had always been looked upon as a revenue raiser up till 1949 when the General Income Tax was brought into force thus introducing a relatively high marginal as well as effective rate of progression into the tax system. Unfortunately the General Income Tax was unable to reach one of its objectives, i.e. redistributing income as the legislation and its administration suffer from various elements of inefficiency.[2]

Indirect taxes on the other hand, with their regressive nature, were adequate in raising the needed funds to cover any increase in the public expenditure because of their administrative simplicity. Customs and Excise duties served basically as a source of revenue to the Government and secondary, as a protective device for several industries.

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1. Government deficits, calculated by comparative changes in Government debt and Government deposits are as follows: (in £E millions).

Year :	1950	1951	1952	1953	1954	1955	1956
Deficit:	-7.9	-45.9	-53.3	+2-2	-2.6	-50.1	-97.2

See, U.N., Economic Development of the Middle East, 1956-57, p. 11

2. See Chapters II, III, and IV of this work.

Income taxation, as previously mentioned, was introduced primarily as a revenue yielder, to meet the increasing public expenditure.[1] On the other hand, the Excess Profits Tax was introduced to absorb a sizeable part of the war profits and windfalls, and to share with the taxpayers in their easy-made profits, and hence supplying the Treasury with ample funds to meet the increasing expenditure. On the whole, income taxation has not so far played an important part in the stabilization of the economy for several reasons, one of the most important being the limited effect of any change in the income tax rates on the economy. Individuals affected by the tax are very limited in number (nearly less than half a million out of a population of 24 millions).[2] Another reason is the inefficient administrative machinery of the tax which must limit its economic effectiveness.

By and large, therefore, Keynesian-type fiscal policy, has not been fully applied to the Egyptian economy. This is not only due to the old classical methods adopted by the Ministers of Finance but also to the backwardness of economic structure as a whole. To apply Keynesian technique to any economy, obviously certain machinery has to be fully developed; such as banking institutions, the market structure, and the tax system.

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1. See also Chapters II and III of this work.

2. Nearly one person out of 50 has some connection with income taxation. (Statistics of the Numbers of taxpayers liable to Income Taxation; Statistics Division, Taxation Department, 1955.)

CHAPTER II.

THE EVOLUTION OF THE EGYPTIAN TAX SYSTEM.

The main purpose of this Chapter is to discuss briefly the background of the structure of the Egyptian tax system in general and then to concentrate on the development of the Egyptian income taxes. As income taxation is new to the Egyptian fiscal structure, it is deemed desirable to study the situation before the introduction of these taxes. Accordingly the discussion will be divided into three main sections following the dates and periods of important changes in the fiscal system which will help us in understanding and elaborating the position of the newly imposed income taxes. The first section covers briefly the period previous to 1939 when the first income tax, in its modern form, was introduced. The second section, includes the period from 1939 up to 1948 during which the Schedular Income Tax with its impersonal characteristics was the only tax on income. During this period, however, a special fiscal measure was introduced to overcome a specific purpose created by the outbreak of World War II; that was the Excess Profits Tax. The third section includes the period from 1949 up till the present during which the Egyptian taxes on income have been reshaped and supplemented by the General Income Tax with its personal objectives.

A. The Situation before 1939.

The main source of revenue for the Egyptian budget at the beginning of this century was twofold. The first was the direct taxes on buildings and land. The second was Custom and Excise Duties. Custom duties were governed by certain Commercial Conventions and the rates of duties could not be increased without approval by the signatories beforehand. In general the situation of the Government was bound by the Capitulations,[1] and no other tax could be imposed that might affect 'Foreigners' without consulting the Capitulary Powers. Accordingly public expenditure was affected and the social welfare was deteriorating resulting from lack of funds.

The financial and political hardships of the 1870's brought difficulties to the Egyptian economy and the surrender of its wealth and public fiscal resources to the foreign creditors in order to guarantee payment of the debts. The foreign powers, especially France and Britain exercised their full power in imposing restrictions on the Egyptian Government concerning the levying of taxes and especially on foreigners. According to Capitulations the Government was unable to levy any tax on foreigners, and, therefore, it was unjustifiable to levy any tax on Egyptians only. In fact the whole public revenue and expenditure were subject to a dual foreign control, British and French.

The only direct taxes existing up to 1884 were those on land and palm trees. The former was based on the rental value of land of 28.64% with a maximum of 164 P.T. (£1:13:9) and minimum 18 P.T. (3/9d.) per acre. The rental estimates on which the tax was based were to be valid for 30 years. This resulted in the inefficiency of the tax system in times of economic fluctuations due to its inflexibility. The other tax was an impost of palm trees at a rate of 10% of the presumed yearly output. These two taxes supplied about 70% of aggregate revenue.[2]

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1. Certain Conventions provided 'Foreigners' with extra-territorial juridicial treatment. Such Conventions were known as "Capitulations" through which the privileged nationals of friendly nations enjoyed liberty of residence, freedom of travel and trade, freedom of religious practice, immunity from extra taxes and other obligations which might be imposed.

2. A. M. Moursi, Income Tax, Vol. I pp. 126-130 (in Arabic).

An attempt was made by the Egyptian Government to impose a house tax in 1884.[1] Immediately an International Conference was called as foreigners refused to pay the tax. The Conference justified the imposition of the tax on rental values of houses after deducting the necessary expenses for maintenance.

From 1885 to 1930 the land tax and the house tax were the only direct taxes in Egypt which supplied a relatively large amount of revenue to the State, an average of about thrity to forty per cent of total tax revenue. The inflexibility characteristic of these taxes prevailed and because of lack of funds the Government was unable to meet the 1930's depression through increasing public expenditure.

In 1930 the Government started revising its Custom duties after regaining its full authority to levy the full rates on imported commodities. The new tariff came into force in 1931 but its yield was below expectations on account of the international economic crises which produced a sharp reduction in imports. The Government was compelled to levy a tax on the earnings of its personnel in September 1931 at a rate of 2% and this expedient supplied an amount less than a million pounds. Exemption from this levy was granted to lower ranks in 1936. In 1939 the tax yield decreased to about £E300,000 and it was then repealed, being superseded by the new Schedular Income Tax.

As the land had to be reserved as a guarantee for servicing external debt and as the house tax raised a very small sum, the financial situation of the Government became very critical. It had to adopt a deflationary policy instead of an expansionary one in order to comply with the obligations which necessitated keeping any budgetary surplus in the Reserve Fund to guarantee the future payment of the debt

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1. Op. cit., p. 125

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charge.[1] More important public works had to be completely curtailed and this intensified the existing deflationary pressure.

The over-all burden of taxation during the first period under discussion can be judged from the situation prevailing during World War I and the two years after it. The yield of direct taxes which was paid by the individuals composing the property owners was stationary at £E5.6m., but the revenue from public services and regressive indirect taxes increased from £E11.8m. in 1913 to £E22.7m. in 1918/19. In general, the policy adopted by the Government during the War seemed to have widened the gap between the rich and the poor. While cotton growers and dealers amassed wealth through a sharp increase in prices, the poor were fighting to maintain a subsistence level.[2]

The fight to gain control over economic as well as political affairs continued during the 1930's. and Egypt in 1936 concluded a political agreement with Britain.

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1. In 1913 the Egyptian Government revenue was £E17.4m; 32% of it was supplied by land and house taxes; 22% was supplied by Custom and Excise duties and other minor indirect taxes, and the remaining 46% came from State Railways, telegraph, telephone and postal services, public domain and profits from other sources. The system of keeping a Reserve Fund for emergency was a dominant factor in the Egyptian fiscal system which lacked the necessary flexibility. The Reserve Fund reached £E4m. in 1915/16 and increased to £E12.4m. in 1918/19. The Reserve Fund was the tool which helped the various Ministries of Finance to balance the budgets in all circumstances. T. Younes, The Budget; Series of Lectures delivered for the Students of The Tax Institute, Cairo University, 1950.

2. Cotton prices increased from $12.01 per kentar in 1914/15 to $87.81 in 1919/20 and to $200 in 1920/21, it was estimated that the family expenses of the poor classes increased by 179% by the end of the War while their earnings went up by 80% only. (Cf., A. E. Crouchley; The Economic Development of Modern Egypt, 1938, p.192)

Later in 1937 Egypt succeeded in terminating Capitulations and thus regained its long-lost fiscal sovereignty. Immediately after the abolition of Capitulations, Government and Parliamentary Commissions discussed how to reform the fiscal system in general and how to construct a suitable tax system. The Parliamentary Commission put forward to Parliament a draft law of the Schedular Taxes on Income in 1938. Later, at the beginning of 1939 the Law was enacted.

B. The Schedular Income Tax as the Main Tax on Income (1938-1948).

(1) The reasons behind the imposition of the Schedular Income Tax:

The new Schedule I. Tax of 1939 was a copy of the French Schedular Income Taxes of 1917 with some modifications taken from other European systems. It was not accompanied by a general income tax as was the case in France. The adoption of the French system was due mainly to the basic structure of the Egyptian Civil Laws which were, and still are, based on the Napoleonic Code modified to suit the social structure of the Egyptian community. Therefore, as the basis of the legislative structure in both countries were alike, it was a quick and easy procedure to adopt the French Income Tax.

The reasons which stimulated the introduction of the 'income tax' could be divided into two main categories:

=a= The need of revenue to meet the increasing demands for reforming social and defence plans. As soon as Egypt's hands were freed on her fiscal affairs, the Government found that it was time to find new resources for the necessary social reforms which were at a standstill for the lack of funds. Why, it may be asked, was it necessary to impose a new tax on income and while not imposing a tax on Capital and wealth or an increase in the rates of the existing taxes? It was believed that to increase the rates of property taxes would have caused great harm and injustice to landowners as they had been bearing a relatively heavy burden of direct taxation for a long time.

Another political factor was that most of the members of Parliament were landowners and to increase the low rates of land tax would incur great opposition.

Public loans could be considered as a means of financing public expenditure, but public borrowing at that period was considered as an improper and inadequate device to finance public expenditure for the following reasons:

(1) In the case of foreign borrowing, this idea was completely neglected for the psychological complexes which resulted from the financial crises of the 19th century. Egypt had suffered considerably politically and economically from her foreign debt policy during the 19th century; therefore, the Government was not in a position to discuss foreign borrowing especially just after Capitulation had been abolished.

(2) The idea of domestic public borrowing was abandoned for the following reasons:

a) The predominance of an imperfect capital market;

b) the lack of banking institutions, especially the lack of a central bank;

c) the low rate of savings in an underdeveloped economy such as Egypt;

d) as a consequence of the above aspect, a relatively high rate of interest for medium and long-term loans is an important reason for abandoning the idea of public borrowing as the high cost of debt service will render any public loan uneconomical in the long run;

e) According to classical, and also to neo-classical viewpoint, the government of the thirties and early forties in Egypt believed in the idea that government revenues have to cover current government expenditure, whereas Capital expenditure may be met by receipts from loans if such loans were believed economical and productive in the long-run. Therefore, following this line of thought the Government of that period believed that public borrowing to meet current expenditure was a highly undesirable, as well as unwise, policy to adopt.[1]

Since the Egyptian Revolution of 1919 great emphasis was put on the improvement of education, health and other social conditions in order to alleviate the people's sufferings. In 1913 less than a million pounds was spent on welfare out of a budget of £E16m. or about 6%; in 1937 welfare expenditure was 14.3% of the aggregate outlay.[2]

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1. T. Younes, op. cit.

2. Ibid.

The general trend afterwards was the rapid increase in social welfare expenditure in order to make up the long-delayed reforms.

Defence expenditure was increasing sharply after the conclusion of the 1936 Anglo-Egyptian Agreement. Egypt had to depend on herself in defending her territory and, therefore, had to reorganise the army.[1] The Anglo-Egyptian Treaty of 1936 required an additional revenue to meet its obligations which in fact reached £E1.2m. between 1939/40 and 1942/43.[2]

=b= The second factor used to justify the imposition of the income tax was the necessity to achieve equity in distributing the fiscal burden. Land and buildings taxes besides the indirect taxes were the main sources of public revenue for a long time. The burden of indirect taxes fell heavily upon the poor classes while other individuals and companies enjoyed a complete immunity from any fiscal impost on their earnings or profits.[3] Therefore, the reformers found that such resources had to be fiscally exploited in order to attain an equitable distribution of the tax burden which was highly regressive. In addition, the public expenditure on social welfare was very small, but increasing.[4] This state of affairs had to be readjusted and the solution was to levy an income tax on the different sources of income.

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1. Before 1936 the burden of defending Egypt against attack was on Britain and, therefore, there was no need for a full army. Defence expenditure was only about 5% of total outlay in 1936. cf. Final Accounts, Fiscal Year 1935-36, Egyptian Government, Ministry of Finance 1939.

2. Statistical Year Book of Egypt, 1947.

3. With the exception of the tax levied on the salaries of Government employees in 1931 which, as previously mentioned, was repealed in 1939.

4. To illustrate this situation the indirect taxes were 75% of total taxes in 1937 while the welfare expenditure was £E6.2m. out of a total outlay of £E42m. or 14.3%. "The Egyptian Budget", 1936/37.

(2) The Schedular Income Tax during World War II:

When World War II broke out the new Schedular Tax had just started to function but its yield was very small, less than half a million pounds of 1939. According to the Anglo-Egyptian Treaty of 1936 all facilities of supplies, manpower and finance had to be provided for the forces. This situation increased the State expenditure on defence which had to be expanded from £E2.9m. in 1937/38 to £E7.7m. in 1939/40.[1] A budgetary deficit appeared in that year amounting to £E1.77m. which was met by drawing on the Reserve Fund. Although the year 1939/40 was the first full year since the introduction of the Schedular Taxes, their productivity was noticeable; they supplied £E2.7m. or about 43% of the yield of both land and buildings taxes.[2]

The extraordinary expenditure by the Allied forces during 1940-42 and the shortage of consumption and capital goods created an inflationary pressure on the Egyptian economy which had to find ways and means to control such a situation. On the other hand, the Government had to find a new source of revenue to meet the increase in the public expenditure which was due mostly to the general rise in prices. Therefore, taxes, as fiscal measure, were used in fighting inflation and also in supplying the increase in expenditure. Commercial and Industrial Profits Tax was increased gradually reaching a rate of 12% in 1942.[3]

An important step was taken in fighting inflation and that was the imposition of the Excess Profits Tax in 1941. The tax was levied to absorb and share businessmen in their windfall gains which were due to the great demand on locally produced commodities which were unobtainable and free of external competition as imports were decreased sharply.

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1. U.N., Public Finance Information Papers, Egypt, 1951.

2. All direct taxes supplied 23% of aggregate revenue compared with 16% in the previous year. The Egyptian Budget, op. cit.

3. The original rate for 1938/39 was 7%

The Government found it necessary and equitable to participate in such windfall profits.

Moreover, the Government had to find another source to supply the Treasury with the needed funds to cover the rapidly increasing expenditure due to the increase in prices. Besides the war created new expenses which had to be met such as civil defence, high-cost of living subsidies.

Summing up there were three main reasons behind the imposition of the E.P.T.: (a) Achieving social equity in charging only the individuals and businesses who profited from the War situation in paying their share to meet the War expenses; (b) producing a further source of revenue; (c) controlling inflation through price limitation, as the rationing system had proved inadequate in most cases especially with the existence of the black market. Besides, the rationing system did not include all types of commodities. Prices of rationed-free commodities soared and some form of control had to be devised. E.P.T. was implemented so as to help in checking the increase in prices.

The E.P.T. was levied on profits exceeding a standard amount of the pre-war level (i.e. 1937, 1938, or 1939 profits) or equal to 12% of the capital actually invested. Progression was applied in the rates of this tax as they ranged between 20% on the excess profits not exceeding a quarter of the basic figure, and 50% on the excess profits exceeding one half of the basic figure. The rates were increased two years later reaching 75% of that part of the excess profits over three quarters of the basic amount. The tax became an important revenue-earner especially during the first five years. E.P.T. was repealed in 1950 after being in force for exactly ten years.[1]

The fiscal system of the Egyptian Government during the War was in no difficulty especially in meeting its expenditure. Economies were made mainly on social expenditures. Through this the Government realised a surplus nearly every year between 1940 and 1945. Taxation supplied about two thirds of the aggregate revenue, and income and

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1. The tax was an important source of Public revenue as compared to other direct taxes. It supplied over £E58m. in almost a decade; over 60% of the aggregate yield of the Schedular Taxes on income during the same period.

other property taxes provided an average revenue equal to 22% of the aggregate.

Table 8 illustrates these points:-

Table 8. Egyptian Revenue and Expenditure during World War II. (£E mn.)

Year	Expend- iture (1)	Revenue (2)	Taxation (3)	(3) as % of (2)	Income & Property Taxes (4)	(4) as % of (2)
1940/41	42.7	43.6	26.2	60	8.4	19
1941/42	46.1	56.3	33.2	59	10.3	19
1942/43	56.6	67.1	42.4	63	17.8	26
1943/44	71.9	77.7	48.0	61	21.7	27
1944/45	82.1	87.7	56.5	64	19.4	22

Source: U.N., Public Finance Information Papers, Egypt, (1951)

As mentioned before, direct taxes on land and buildings were constant during the War and also during the three years after ; it yielded £E6.14m. in 1937/38; £E6.3m. in 1939/40; £E6.6m. in 1941/42; £E5.6m. in 1943/44; £E6.0m. in 1945/46 and £E5.36m. in the period from May 1942 to February 1948. While property taxes were stagnant, taxes on income were increasing in yield and the proportion of the first category to total direct taxes became 3% in 1946/47 compared to 70% in 1939/40; and obviously the balance charged as income taxation was 69% of total direct taxes in 1946/47 with the main burden, in relative terms, being levelled on Commercial and industrial enterprises.

In 1946 some Members of Parliament raised the question of the role of the existing Schedular Income Tax in distributing the fiscal burden. They introduced a draft law before Parliament in June 1946, designed to secure a measure of equality, proposing the levy of a tax on total income.

C. The Introduction of a General Income Tax as a Complementary Tax on Income.

The idea of imposing a general income tax is not a recent one. It actually had been studied when the Schedular Taxes were under discussion in 1937/38. But it was thought that the time was not ripe to levy the complementary tax on total income as the Schedular Taxes were quite sufficient in supplying the Government with the needed revenue.

Later, during 1945, a Committee was formed to study direct taxes in general and the Schedular Taxes in particular. The imposition of the general income tax was one of its main topics on the allegation that the existing tax system was far from achieving social equity as the Schedular Taxes are impersonal in their objectives.

The idea of imposing a general income tax was a controversial one and had been subject to several debates inside and outside Parliament. Generally speaking, there were two groups, one advocating the imposition of the tax while the other was against such imposition.[1] They supported their ideas by the following argument:

a. Arguments against the imposition of the tax:[2]

(i) The then existing tax revenue was more than sufficient to cover the Government expenditure as the final accounts showed a continuous surplus.[3] Therefore, the need to levy a new tax on total income for revenue purposes could be easily offset.

(ii) The administration was inadequate and would not be able to cope with the existing taxes especially the Schedular Tax. The arrears cases without assessment were enormous . It was proposed that it would be beneficial to concentrate on the improvement of the assessment and collection of the Schedular Tax and, therefore, increase its yield. Accordingly the need for imposing a new tax for revenue purposes did not exist.

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1. Kamal el-Garf and A. el-Kadim, The General Income Tax, pp. 9-15

2. The opponents were mostly Members of Parliament who represented the landowners.

3. There was a continuous budget surplus since 1940/41 which amounted to £E1.12m. for that year, £E10.27m. for 1941/42; £E10.59m. for 1942/43; £E5.83m. for 1943/44; £E5.63m. for 1944/45; £E8.2m. for 1945/46; £E10.30m. for 1946/47; and £E6.95m. for 1947/48. (See U.N., Public Finance Information Papers, Egypt, 1951).

(iii) Some Schedular Taxes were levied on income calculated on an arbitrary basis such as the tax on non-commercial professions, while others were not completely into operation.[1] Thus a proper enforcement of the Schedular Taxes should be of primary importance. Some sources of income were exempt, e.g. agricultural profits, and it was necessary that such profits should be taxed. This evidence indicated a major source of inequality: between the individuals on one hand and in the fiscal treatment of the various sources of income on the other. Therefore, it was a necessity to adjust the defects of the existing tax before even thinking of levying a new one.

(iv) The imposition of a general income tax while the E.P.T. was still in force would be considered as increasing the fiscal burden.

(v) If the newly proposed tax were to be enforced, its administration would prevent it being efficient as the majority of the taxpayers did not have any proper accounts to show their real income. On the other hand, the introduction of the general tax on income would require an enormous administrative expenditure and thus the tax would become uneconomical from the State's viewpoint.

These were the basic arguments against the imposition of the general tax on income which were criticised by the advocates imposing the tax.[2]

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1. Especially the Schedular Tax on interest paid on bank deposits, and on other debts, Articles 15-17, Law No. 14 of 1939.

2. The defenders of the imposition of the tax were mostly academic persons and members of Parliament with non-feudalistic beliefs.
See, Minutes of the Upper House, 21/2/1949.

b. Arguments for the imposition of the general tax on income:

(i) The main purpose of imposing the tax would be to achieve equity in distributing the income tax burden. The Schedular Taxes with their impersonal characteristics were far from attaining an equitable distribution as they ignored the personal aspects of the various taxpayers which affects their ability to pay the tax.

(ii) Proportionality in personal income taxation was out of date in achieving the equal sacrifice doctrine while progression in the rate was being widely considered as the adequate device in reaching equality in sacrifice within the framework of the theory of diminishing utility.

(iii) The State needed more revenue in spite of the continuous budget surplus as there were many economic and social projects which were held at a standstill during the War period.

(iv) On the other hand, the proposed tax would act as a deterrent to the overwhelming inflationary pressure which was increasing, after the end of the War.[1]

Finally, after severe attacks from property owners in general and landowners in particular, the Law of the General Income Tax was given a final reading in August 1949 and the long-awaited complementary tax on income came into being. The tax was levied on total incomes of the Calendar year 1949. The structure of the tax, which was originally adopted from the French (before the 1948 reform) and Belgian models, is reviewed in the Appendix along with the Schedular Income Tax.[2]

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1. Minutes of the Lower House (House of Representatives) 2/6/1948.

2. Page 46.

Since 1949 the income tax system could be considered as relatively complete although some sources of income are still untaxable. The inequality of the Schedular Tax due to its impersonal characteristics is modified and mitigated by the complementary tax on total incomes through its personal objectives. The question of equity regarding the Egyptian income taxes is to be discussed in a following Chapter when considering the performance and the efficiency of the system.

During a period of almost a decade the statutes of the two taxes on income have been under a continuous change with a view to clarifying the ambiguity of the legislation, to filling up the loopholes or to introducing a major change in the technical make-up of the tax. As with most income tax systems, the Egyptian system has been evolved for socio-economic as well as for administrative reasons.[1] This state of affairs; i.e. the enormous number of amending legislations and regulations, created a confused and ambiguous atmosphere around the interpretation and the enforcement of income taxes.

During the period under analysis several taxes were levied in addition to those previously mentioned. These were of three major categories. The first in importance is the Defence Tax levied in July 1956 to supply the Treasury with revenue to cover the increasing defence expenditure. The estimates of the increase in defence appropriations in the fiscal year 1956/57 were £E23m.[2] Therefore, an immediate source of revenue was needed to cover such great increases in expenditure. This tax is

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1. Only the basic changes of significant social or economic implications will be discussed when judging the efficiency of the system. (Part II.)

2. <u>The Budget Report for the year 1956/57</u>, Ministry of Finance and Economy.

levied in addition to the Schedular Tax, the G.I. Tax as well as the Property Taxes. The rate varies from 1% on small salaries, wages up to 10% on the total income subject to the G.I. Tax above £E30,000 a year.

Apparently the Defence Tax is to be a separate imposition but in fact it produces an increase in the existing rates of direct taxes in an indirect way. For political and psychological reasons it took the shape of a separate tax. It has no doubt increased the burden upon taxpayers but in order to reduce the psychological effect on the people it was given the name of 'Defence Tax' so as to make it easier for the people to accept it without much resentment.[1]

The second category is an additional tax levied to meet part of the expenditures of provincial councils and municipalities. It takes the form of an excess percentage over the main rate of the Schedular Tax, G.I. Tax and property taxes. As a matter of fact special levies to meet the expenses of certain municipalities were in existence even before the introduction of the Schedular Tax. But in 1950 a general law attempted to organize the levy of additional taxes on top of the Schedular Tax. The municipalities of Cairo and Alexandria, the two major cities, have their own autonomous legislative power in imposing and collecting additional levies on the taxpayers' income within their boundaries. But to attain a control over the rates of the additional levies, the Central Government had to fix a maximum of 10% on the basic rates of direct taxes.

In the third category is a newly introduced tax designed to achieve social objectives. The tax is levied on any type of remuneration paid to a corporation's

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1. The Government on several occasions has announced its intention of not increasing the rates of the existing taxes and, especially, in the last three successive budget reports.

director over and above the amount of Schedular Tax and G.I. Tax paid.[1] The Schedular Tax is deducted from the remunerations before the new tax is imposed. The rate of the tax is progressive, ranging from 10% on incomes above £E2,000 and not over £E3,000, and 80% on incomes over £E10,000. The aim of this tax could be easily deduced from from the recent general drive against feudalism and towards the redistribution of income and wealth. Taxation was, therefore, used as a device to attain such an objective along with other direct social reforms. For example, a significant amendment of the Companies Law took place in August 1958 reducing the number of Directorships tenable by one person from six to two, with the exception of the Boards of Directors of the Central Bank, and other banks or companies in which the State or a public institution participates; in these cases membership is confined to one Directorship only unless authorization is given by Presidential Decision. The Managing Director must confine his activities to one company.[2] The maximum remuneration that a member of a board of directors can get from a corporation salary, attendance allowances, or other advantages in kind, is now fixed at £E2,500 per annum.

Generally speaking, the above-mentioned laws have established a kind of safety valve to prevent the growth of industrial feudalism especially as the country is moving quickly towards industrialisation. The introduction of these important amendments gave the State, through its legislative power, a control over the private sector of the economy in order to attain an efficient utilization of the business sector.

The three categories of additional taxes on income are in fact an increase in the rates of the main Schedular and General Taxes on income. Their introduction was

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1. Introduced in 1957 by the Law No. 153 and amended by Law No. 99 of 1958.

2. He is also subject to the age limit of 60 years, with the exception of members owning at least 10% of the share capital.

necessitated by temporary conditions which might cease in the short-run. But other additional taxes are levied with the intention of covering a continuous public expenditure or to attain a long-run socio-economic reform. The redistribution of wealth and income, so as to close the huge gap between income groups, is considered to be one of the main objectives of the present regime: The Land Reform was the first step towards this aim. It limited land ownership to 200 feddans (one feddan = 1.038 acres). The drive continued afterwards to eliminate other types of "unproductive" wealth accumulation which might lead to misallocation of the nation's resources if proper steps were not undertaken.

APPENDIX.

The Structure of the Egyptian Income Tax System

The Egyptian income tax system is basically divided into two main taxes; (a) The Schedular Income Tax, and (b) The General (Global) Income Tax.

A. The Schedular Income Taxes:

These taxes were levied by Law No. 14 of 1939 which includes the following specific taxes:-

1. Tax on Income Derived from Personal Movable Property:

At present, the rate of this tax is 17% and it is levied on:

a) Dividends, interest and all other profits derived from shares of any kind, and of founders' share in companies and general enterprises whether such dividends are periodical or not, and whether the distribution has been made in cash or gratuitously in the form of shares, bonds or founders' shares, or in any other form, even indirectly.

b) Interest and profits from Capital invested by sleeping partners in a limited partnership.

c) Interest and all other profits derived from bonds, securities, Treasury bonds, loans of every kind issued in any way by the State, or by Provincial Councils or by municipalities and from securities or debentures issued by all companies and undertakings mentioned above in (a) and (b) with the exception of: (i) such securities, debentures or bonds as are specifically exempt by law from this tax, and (ii) credits of a professional nature with certain reservations provided in the law.

d) Fees of membership of the Board of Directors of companies with the exception of profits or fees due to designated members of the Board for their managerial work provided that not more than two directors of any one company may benefit from this exception, and that the total sum accruing to each does not exceed £E3,000 yearly in whatever form it may be received.

e) Redemptions and repayments of shares if certain conditions are ascertained.

Dividends, interest arrears and all other profits derived from movable foreign securities which Egyptian insurance and reinsurance companies are compelled to deposit, and maintain in deposit, abroad in the form of guarantees and reserves to cover matured claims and current risks, are exempted.

Subject to certain rules and conditions, the dividends which are paid out by an Egyptian holding company are exempted from the tax in proportion to that part of the profits derived in return for its participation in the share capital of a subsidiary provided that tax shall have been paid on such profits when distributed by the subsidiary.

The law does not include exemptions for personal considerations. The tax is collected at source on the payment of any incomes that are subject to it. Companies, business undertakings or bodies of persons liable to pay any taxable income are required to furnish the Revenue Authorities with all documents and records relating to the income paid.

The basic principles governing the imposition of this particular tax is the principle of <u>political allegiance</u> with regard to Egyptians, wherever they reside, and the <u>economic allegiance</u> for foreigners domiciled or habitually residing in Egypt.

2. <u>Tax on Income Derived from Debts, Deposits and Guarantees</u>:

The rate of this tax is 17% and it is levied on interest on all privileged, mortgage and ordinary debts and on all deposits of sums of money or currency guarantees due to Egyptians or foreigners domiciled or resident in Egypt, even if such interest is payable in respect of capital invested abroad.

Interest accruing from all capital invested in Egypt is also liable to this tax even if the persons entitled thereto are foreigners having no actual or legal domicile in Egypt.

Interest on debts or deposits which credits of professional nature is exempt from the tax in so far as it is proved that such interest is included in the accounts of enterprises situated in Egypt which are subject to the tax on commercial and industrial profits.

The tax is at the sole charge of the person entitled to the interest and it is payable on the gross amount of interest and becomes due by the mere fact of the payment of the interest, however effected.

The tax is sometimes withheld at the source, while in other cases the creditor has to pay it to the Revenue Authorities. Some declarations are required to be filed by both the debtor and the creditor in order to ensure the collection of the tax.

3. Tax on Profits Derived from Commerce and Industry:

The rate of the tax is 17% and is annually levied on profits derived from commerce, industry, commercial professions or exploitations, mining or other concessions or undertakings, without exception, other than such undertakings as are specifically exempt by law.

The provisions of this tax apply to the profits of joint stock companies whatever the object of such companies.

In addition the law enumerates some different cases to which the tax also applies such as, the persons and companies who habitually purchase buildings or businesses with a view to resale, stockbrokers, exchange brokers, agents working on commission, persons and companies who sell their land in plots after introducing preliminary works or let on lease commercial or industrial premises supplied with the furniture or plant necessary for their use, or rent agricultural land and give it on lease to a third party wholly or in lots.

The tax is chargeable to the profits made by all establishments operating in Egypt.

The exemption limit varies from £E100 to £E150 according to the marital situation of the taxpayer, (single, married and without children, or married with children). If the net profits are more than double the limits of these exemptions, the taxpayer will not benefit by any exemption.

Special provisions are enumerated to avoid double taxation within the other Schedular Taxes. For example, income derived from invested capital in personal movable property, buildings or agricultural land which forms part of the assets of an undertaking, subject to the Commercial and Industrial Profits Tax, may be deducted to the extent of its net amount when computing the net taxable profits, after deduction of the proportion of expenses appertaining thereto, which is calculated at a fixed rate of 10% on the amount of such income.[1]

Joint stock companies and limited partnerships are entitled to deduct from the amount of their taxable profits a sum equivalent to the amount distributed and liable to the Schedular Tax on Movable Property.[2]

The taxable income under this Schedule is fixed by the net profits realized during the previous year after deduction of all charges and losses. Capital gains or losses realized through the functioning of the business are treated as ordinary gains and losses.[3] Net profits subject to tax are established by the general result of all business transactions carried out by the firm during the financial year.

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1. Law No. 14 of 1939, Article 36.
2. " " " " " Article 35.
3. " " " " " Article 39.

4. Tax on Wages, Salaries, and Similar Incomes:

This tax is levied on wages, salaries, indemnities, emoluments, pensions and annuities paid by the State, Municipal and Provincial Councils, to any person residing in Egypt or abroad except cases exempted by special provisions. Moreover, all wages, salaries, pensions and the like paid by individuals, undertakings, or any organisation to any person residing in Egypt or to anyone who is residing out of Egypt in respect of services performed in Egypt, are subject to this tax.

The assessment of this particular tax is based on the total amount of salaries, emoluments, etc., and applies in addition to all privileges in money or in kind. The tax is always collected at the source by the employer after deducting contributions made towards pensions not more than 7.5% of their aggregate wages or salaries.

Workmen and employees on daily pay with wages up to P.T.30 per day are exempt, in all other cases they are subject to a tax of 1% on that part of their wages in excess of P.T.30 and up to P.T.60, and to 2% for that part of their wages which exceeds P.T.60.[1]

The exemptions limit from this tax range from £E100 to £E150 according to the marital status and children.

The rate of this tax is progressive and varies from 2% up to 9% according to the amount of income.[2]

5. Tax on Profits of Non-Commercial Professions:

This tax is levied on profits of liberal and non-commercial professions exercised independently by the taxpayer where the principal source of income is work. This tax is also levied on any profession or activity which is not subject to any other tax. The following, however, are exempt from this tax:-

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1. P.T.100 equals one Egyptian pound.
2. Law No. 14 of 1939, Article 63 (1).

a) All associations of non-profitable object within the limit of their social, cultural or sporting activities. Scholastic institutions are also exempt from this tax.

b) Any agricultural enterprise which is not constituted as a joint stock company.

The rate of this tax is 11% on the net profits realized during the preceding year after deductions of all necessary expenses for the exercise of the profession.

Persons exercising a profession which necessitates a University or College degree are exempt from this tax during the first five years from the time of graduation. On the other hand, these persons holding university degrees are favoured by a new amendment which took place in 1955. They are given the choice of being assessed according to their actual profits or according to the period of practice which starts according to the law from the elapse of the fifth year after graduation (1). On the other hand this new legislation excluded those who realized £E1,000 or more as net profits during the years from 1951 - 1954. Therefore, their profits are subject to ordinary assessment of this tax at a rate of 11%.

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(1) Law No. 642 of 1955, Article 1, states that the assessment of the tax on liberal professions which require a university degree is as follows:

a. £E15 yearly for the professional who has been graduated for not more than 10 years (the first 5 years after graduation being exempted);

b. £E30 yearly for the professional who has been graduated for not more than 15 years;

c. £E50 yearly for those who have been graduated for not more than 20 years;

d. £E80 yearly for those who have been graduated for more than 20 years.

The basis for personal, marital and dependent reliefs are the same as in the case of tax on wages and salaries, but with the exception of thos taxpayers who chose to be assessed according to the fixed estimated tax.

B. <u>The General Income Tax.</u>

This tax was levied in 1949 to supplement the Schedular Taxes. It is imposed on the total income of all Egyptians wherever they are domiciled, and on foreigners domiciled in Egypt, even if their income is derived from foreign sources. But foreigners who are not domiciled in Egypt, they are only liable to the tax on that part of their income accruing within Egypt. The tax is levied on the total net annual income received by the taxpayer during the previous year. Thus the income is calculated on the revenue of real estate, movable property, professions, salaries and the like. The determination of the revenue of real property, whether buildings or agricultural land, may be fixed on the basis of the estimated rental value after deducting 20% in respect of all expenses, or on the basis of the actual revenue received, as the taxpayer may choose. The remaining items of income are determined according to the rules prescribed for payment of the specific tax on each of them.

The law has exempted from the tax all members of Diplomatic and Consular Corps on condition that reciprocity is regarded, and within the sphere of this reciprocity. It also exempts foreign experts and technicians residing in Egypt with regard to that part of their income accruing from foreign sources.

Special allowances for dependents and wife are provided in the law over and above other allowances granted under the Schedule Income Taxes. The tax is levied on all net incomes above £E1,000 at a progressive rate reaching 80% on annual incomes more than £E50,000.

Other Direct Taxes Levied on Income.

1. Excess Profits Tax.

In 1941 Egypt imposed a tax on the Excess Profits in order to fight the inflation and to have its share from windfall gains realized and caused by the break of the war. It was in the Belgian model, and charged on profits exceeding a standard amount of the pre-war level or equal to 12% of the income actually invested. The principle of progressions was applied and the rate ranged between 20% on the excess profits not exceeding a quarter of the basic figure, and 50% on the excess profits exceeding one half of the basic figure. Two years later the rates were increased reaching 75% of the part of the excess profits over three quarters of the basic amount.

The Excess Profits Tax was repealed in 1950 after being in operation for exactly ten years during which time it supplied an adequate yield to the Treasury.

2. Additional Taxes on Income Levied for Specific Organisations.

a) An additional tax is levied on income derived from:-
Commercial and Industrial Profits and Immovable Property for Municipalities and Rural Councils.

b) An additional tax levied on all sources of income for defence. (1). This tax is imposed on income derived from agricultural land, buildings at a rate of $3\frac{1}{2}$% and $2\frac{1}{2}$% respectively computed on annual rental value of the asset; or income derived from movable property, industrial and commercial profits, non-commercial professions at a rate of $3\frac{1}{2}$% and, on wages, salaries and the like at a rate of 1% on the first £E500 and 2% on income bracket over £E500. The rules and regulations determining the net taxable income are those applied in the case of Schedular Taxes. This tax is also levied on the global income subject to the General Income Tax at a progressive rate ranging from 2% on the first £E2,500 subject to General Income Tax up to 10% on the income brackets above £E30,000.

PART II.

THE PERFORMANCE OF THE SYSTEM

CHAPTER III

The Income Tax as a Revenue-Raiser

1. Introduction

The rise of modern States has been accompanied by an increase in the number of public functions and the more extensive and elaborate performance of those functions. The functions of the State depend upon the stage of socio-economic development and the prevailing social philosophy.

Public welfare was and is still the basic target of almost every modern State. An analysis of the functions of modern States will indicate the development of the following services for public welfare: (1) public safety, both external and internal, (2) justice, (3) the regulation and control of economic enterprise, (4) the promotion of social and cultural welfare, through education, social relief, social insurance, health control, and other objectives, (5) the conservation of natural resources, (6) and the administration of government financial systems, or expenditure, revenues, and fiscal control.[1]

The expansion of the contemporary State in undertaking and performing the various unlimited services, if compared with that in medieval times, necessitated a large source of revenues to finance such services. Governments usually prefer a current and permanent source of revenue to cover current public expenditure. On the other hand alternative sources of revenue could be easily utilized in order to supply the Treasury with the needed funds if such current source of revenue failed to meet the State requisites. Taxes have been long accepted by most societies as a permanent and convenient source of revenue devised to meet the current public expenditure. Public loans, internal and external, are other alternative methods of raising revenue to support public expenditure.

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1. U.K. Hicks, "The Search for Revenue in Underdeveloped Countries", Revenue de Science et de Legislation Financieres, 1952

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Borrowing has become a very important method in securing funds to meet temporary excesses of expenses over income and to finance public works, wars, and other undertakings. One of the most significant developments in government borrowing has been its persistent increase. Several factors have contributed to the growth of public debts. The great bulk of public indebtedness may be attributed to war and public works. After the nations learned the art of financing wars with loans, they soon acquired the habit of financing public works and other costly services largely by borrowing.

The use of credit has also been invited because there has often been less public resistance to borrowing in the financing of an expenditure than to immediate tax increases. The eventual repayment of a loan out of tax collections is frequently so remote as to be of little immediate concern to the taxpayers. But nevertheless an ample amount of tax revenue has to be in hand to pay the debt expenses at least if not in redeeming the debt itself.

As to the relative share of taxation and government borrowing in the fiscal structure, few general principles can be stated. Taxation should at least cover current expenditure on normal government services. Borrowing is particularly appropriate to finance government expenditure which results in the creation of capital assets or which is otherwise directly productive. Experience varies as to the relative degree of control over expenditure from proceeds of taxation, as compared with expenditure of borrowed money. In some countries, it has been found that borrowed money is more carefully and efficiently spent than tax money. In so far as borrowing is restored to, proper techniques of efficient debt management may become an important factor in lowering costs of financing economic development.

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1. P.A. Van Philips, Public Finance and Less Developed Economy with Reference to to Latin America, pp. 100-111

Taxes, direct and indirect, were devised as an important revenue-raiser required to meet the necessary current expenditure, and to secure the general credit of the government. Upon the power to tax the ability of governments to maintain their credit ultimately depends. Hence more taxable capacity means credit capacity.

Within a developed economy the government finds it easy to borrow from the public. This is due to the highly developed money markets and the banking institutions in particular. The contrast could be easily emphasised about an underdeveloped economy where money markets are imperfect and credit institutions are in a low standard. Also any credit policy has to be carefully studied taking into consideration the low rate of saving which is a well known characteristic of a subsistence economy.

Income taxation has developed and become one of the fundamental sources of revenue especially in highly developed economies such as in Britain and the U.S.A. Egypt as a less-developed country does depend mostly on indirect taxation in raising revenue as income taxation is not fully developed. This chapter is a study of the role of the Egyptian income taxes as revenue-raiser. A short comparison of tax revenues especially income taxes in developed and less-developed countries will take place as an introduction for the forthcoming analysis.

II. Income Taxes as a Revenue-Raiser in a Less-Developed Economy:[1]

Taxation has been the main resource of public revenue besides other resources such as the revenue from the government domain, public enterprises and other fees

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1. A less developed economy as compared to a developed one could be defined according to the U.N. definition in its Report on "The Development of underdeveloped Countries" as "countries which per capita real income is low when compared with the per capita real income in the U.S.A. and Canada ... and Western Europe .../

and donations. Direct as well as indirect taxes co-operate in supplying the Treasury with revenue, but mostly in different proportions. The reliance on direct or on indirect taxes differs from one country to the other depending primarily on the structure of the economy. In most less-developed countries indirect taxes supply a large proportion of revenue while direct taxes are considered a low revenue-raiser. Custom duties and excises are the principle sources of revenue in less-developed countries. Export taxes in primary product producing countries are highly developed and nowadays form a major source of revenue to governments. Before the Second World War export taxes were not relied upon in underdeveloped countries as well as in developed countries because the then widespread belief in free trade and the 1930's depression which resulted in a sharp decrease in the primary products prices. [1]

During and after the Second World War, an enormous pressure was concentrated upon public expenditure of the less-develoled countries due to the following: [2]

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footnote continued from previous page:-
In this sense, an adequate synonym would be poor countries". This definition represents only one of the characteristics of the underdeveloped countries and therefore it seems insufficient for the purpose of real income is not an accurate means of comparison as some countries enjoy high per capita real income and are still considered underdeveloped, viz. Kuweit. A simple and comprehensive definition of the less-developed countries could be reached through enumerating the major characteristics of these countries: they are:

1) Low per capita income due to low productivity and the scarcity of capital.
2) Low rate of savings and hence, investment resulting from low income.
3) Imperfections in the market such as immobility factor, price rigidity, ignorance of market conditions ... etc.
4) Lack of entrepreneurial ability and business administration.
5) The large gaps in the distribution of income and wealth.
6) The rates of tax to national income is low. It is between 10% and 15% in less-developed countries and 30% and 40% in developed countries.

1. U.K. Hicks, op. cit.
2. U.K. Hicks, op. cit.

Source: U.N. Statistical Yearbooks, 1950, 1952, 1957.

TABLE 9

Income Tax Receipts in percentage of Total Tax Receipts, Total Government Revenue and of National Income Years 1939 or 1940 and 1950, 1951 or 1952, and 1956 or 1957 in Selected Countries.

Country	U.K. (in £ million)			Egypt (millions of £E)			Burma (millions of Kyats)			Turkey (Millions of Turkish £)		
Years	1939	1950	1956	1939	1950	1956	1940	1950	1956	1939	1951	1956
National Income	5037	10639	16465	168*	789	1065 /	1213	2744	4336	-	8964	21701
1 Taxes on Income	421.9	1850.7	2294.9	0.4	17.1	E 19.5	-	48.7	224	66.9	412.9	773.3
2 Total Tax Receipts	896.4	3686.9	4641.3	25.8	121.2	156.3	149.5	217.7	600.3	219.6	1241.9	2431.6
3 Total Receipts	943.1	3982.2	5115.7	37.6	158.5	210.9	180	491.6	723.4	266.9	1389	2584
1 in % of 3	44.7	46.6	44.8	1.06	10.7	9.2	-	9.9	30.9	25.0	29.7	29.9
1 in % of 2	47.0	50.1	49.4	1.55	14.1	12.2	-	22.3	37.3	30.4	33.2	31.8
1 in % of Nat. Income	8.3	17.3	13.9	0.23	2.16	1.8	-	1.7	5.1	-	4.6	3.5

Country	Chile (in 1000 million pesos)			Venezuela (in million Bolivares)			Mexico (millions of pesos)			Greece // (1000 millions of drachmas)		
Years	1940	1952	1956	1939	1950	1957	1939	1950	1956	1948	1952	1956
National Income	-	127.8	118.8	-	7973	-	6000	37500	84000	14529	30663	61985
1 Taxes on Income	1.0	11.9	E 77.8	0.9 ≠	461.3 ≠	1115.1 ≠	41.4	794.8	E 1500	246.7	1001.8	2395
2 Total Tax Receipts	2.9	30.6	197.3	197.5	1149.4	2009.5	464	2833.6	5190	1444.4	4328.6	12749.2
3 Total Receipts	3.3	36.2	203.2	340.7	2111.6	5521.2	548.7	33.4	6100	2206.8	5845.5	17163
1 in % of 3	30.3	32.8	38.2	0.26	21.8	20.8	7.5	23.9	24.5	11	17	14
1 in % of 2	34.4	38.8	39.4	0.45	40.1	55.4	8.9	28	28.9	17	23	19
1 in % of Nat. Income	-	9.3	6.9	-	5.7	-	0.6	2.1	1.7	1.7	3.2	3.9

Source: U.N. Statistical Yearbook, 1950, 1952, 1957.

E. Estimates - unavailable.

*National income estimated by M.A. Amis, A Study of the National Income of Egypt, Ph.D., Thesis, University of London, 1950.

/ U.N. Economic Department in the Middle East, 1956/1957. The original source is the National Planning Commission of Egypt.

≠ Direct Taxes on income and wealth. // No information is available before 1948.

1) The increase in the cost of administration which is largely in money terms but if considered against the rigidity of the tax structure the cost is real.[1]

2) Difficulties in borrowing, due to the imperfection of capital market and low rate of savings.

3) The sharp increase in social and economic expenditure due to the Second World War.

These three phenomenon are widespread in most of the less-developed countries.

To complete the foregoing discussion, it is highly desirable to illustrate the role of taxation, direct versus indirect, as revenue raisers in both developed, and underdeveloped economies. Various countries have been chosen as a sample at random for the illustration.[2] For comparative reasons the following table (Table 9) embraces one highly developed country, U.K., and seven underdeveloped countries including Egypt. (Emphasis is given to direct taxes on income.)

The basic characteristic which could be observed from the above mentioned table is that in underdeveloped countries income taxes ratio to national income (at factor cost) is relatively very small if compared with a highly developed country such as U.K. Income taxes, as a general rule, became an important source of revenue and has developed widely since the 1930's. This situation applies to both developed and underdeveloped countries. Before the Second World War income taxation was of minor importance as a source of revenue in underdeveloped areas. Various countries, especially Egypt, did not introduce income taxation until later years of the 1930's and the first years of the War.

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1. Inflation increases prices, but at the same time, the rigidity of the tax system cannot increase the tax revenue at the same rate.
2. The choice of these countries are based on the availability of date converning income taxation.

On the other hand taxation in general in underdeveloped countries represents a ratio which lies between 5% to 15% of the national income. In advanced economy this ratio varies from 25% to 40%. Direct taxes, especially taxes on income, represents a smaller proportion of the total tax receipts in underdeveloped countries, while taxes constitute a bigger proportion. This is due to the low income per capita and mal administration of taxation which is of an overwhelming feature of a less-developed economy. The dependence of less-developed countries on indirect taxes as an important source of revenue cannot be disputed. The main reason is the convenience and the relative efficiency in the assessment and collection of indirect taxes especially import and export taxes. Less-developed countries have also sought refuge in income taxes for social and economic as well as political reasons. The need for revenue to meet the increasing public expenditure, either for current expenses or capital formation and development necessitated the introduction of income taxation during the last thirty years. Political and social motivations depending on the doctrine of equity were an important stimulant for adopting and enforcing income taxation in such relatively poor communities.

It was apparent when poor countries first introduced income taxes that the revenue from these levies would be of small amounts due to various factors mentioned above, viz. poor system of administration, low income per capita. Through time income taxes proved to be an important source of revenue in those countries even with the existence of corruption and poor administration. Taking Egypt as an example in the first year of the introduction of income taxes, 1939, income tax receipts were negligible, 1.06% of total government receipts and 1.55% of total tax receipts. The ratio to national income was 0.23% for 1939. Later in 1950 income taxes produced about 10.7% of total government receipts and 14.1% of total tax receipts while its ratio to gross national income increased to 2.16%.

Such increase in income tax revenue is of considerable importance if we take into consideration the relatively short period of its function, almost 10 years (1939-1950). In recent years, in 1956 and 1957, income taxes produced about 9.2% and 10.5% of total government receipts respectively.[1] The participation of the Egyptian income taxes in aggregate public revenue is low compared to the situation in other underdeveloped countries. From the data provided in Table 9 the average percentage of income tax revenue to total government receipts in most selected underdeveloped countries lies between 14%, as the case in Greece, and 38%, as in Chile. Countries such as Venezuela where natural resources i.e. oil, participate with a big percentage to the national product, royalties are considered as the major source of revenue to the Treasury. In the case of Venezuela it is about 30% of total public receipts, while income tax contributes on average about 20%.[2] Other countries which are basicly producing primary products levy export taxes on their major products directly or indirectly through tax on income derived from dealing in the primary products such as the case in some of the Latin American countries, namely Cuba, El-Salvador, Brazil and others.[3] Egypt levies an export tax on cotton and rice, but generally speaking, the revenue derived from such tax could be considered as of a very small percentage to total tax receipts. It is estimated that total export taxes will supply about £E7.3 million during the financial year 1958/59, or about 4% of total estimated tax revenue.[4]

The general trend of the income tax after the end of the Second World War in less-developed countries shows a steady increase if compared to the pre-war period. The ratio of income tax receipts of total revenue, as previously mentioned has doubled and multiplied since 1939, although the significance of indirect taxes

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1. Statistical Pocket-Year Book, Egypt, 1957 (in Arabic).
2. U.N., Statistical Yearbook 1957, p. 532.
3. In Cuba there is a tax on the sugar mills, on its production, Coffee tax is levied on income derived from growing and trading in coffee in El-Salvador, in lieu of income taxes.
4. The Budget Report for the year 1958/59. Ministry of Treasury, Southern Region,

especially customs and excises preserved its position as an important source of revenue to the Treasury.

111. <u>The Egyptian Income Taxes as a Revenue-Raiser during Two Decades:</u>

(A) <u>Relative Revenue Importance.</u> Income taxation has been in force for almost two decades during which is has supplied about 10% of the aggregate public revenue and about 16% of total tax yield in the average.[1]

Indirect taxes, especially customs duties and excise, were the major components of the total tax yield. The proportion of these taxes to total tax receipts was about 65% in the average. This percentage decreased during the War period due to the shortage of imported goods. This phenomenon could be simply deduced if we compare the yield of direct taxes to the total tax yeld during the War years especially 1942 to 1945, with post-war period.[2] In general, indirect taxation composes about two thirds of total tax revenue. The fact that indirect taxes supply a major part of public revenue in Egypt is also a common and widespread fact in most underdeveloped countries, while income taxation is still in a developing stage.

When a new tax is imposed it is always expected that its yield would be below the normal level if both the taxpayers and the administrative body were unfamiliar with the tax. This was the case in Egypt during the first five years of the income tax imposition.[3] The tax raised small sums during the first five years as the whole structure of the country was unprepared to accept such new taxation which penetrates into most of the individual's affairs. This state of affairs resulted in the accumulation of back assessments which the administration has not yet recovered.[4]

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1. See Table 10 and Figure 1.
2. Compare column (2) with column (3) of Table 10.
3. This does not mean that after the first five years both the taxpayers as well as the tax administration were in complete co-operation and full understanding of the tax. The contrary could still be said at present in a moderate sense.
4. This point will be elaborated later when discussing the effect of administration on the yield.

TABLE 10

The trend of the Egyptian Income Taxes in relation to Direct Taxes, total tax yield and to aggregate public revenue (in million £E)

Fiscal year ending	Taxes on Income (1)	Direct Taxes (2)	Total Tax Receipts (3)	Total Public Revenue (4)	(1) in % of (2) (5)	(1) in % of (3) (6)	(1) in % of (4) (7)
1939	0.4	7.07	26.18	37.62	5.6	1.5	1.06
1940	2.69	9.06	27.60	39.40	29.6	9.9	6.8
1941	2.05	9.71	26.26	43.68	21.1	7.8	4.6
1942	3.76	11.29	33.22	56.33	33.3	11.3	6.6
1943	11.34	18.98	42.46	67.14	59.7	26.5	16.8
1944	14.05	21.16	48.05	77.77	66.3	29.9	18.0
1945	13.44	21.04	56.51	87.73	63.8	23.7	15.3
1946	14.20	22.33	70.23	103.50	63.5	20.2	13.7
1947	13.18	21.24	77.03	109.96	62.0	17.1	11.9
1948	11.08	18.42	71.81	98.93	60.1	15.4	11.1
1949	17.72	23.20	106.37	142.48	76.3	16.6	12.4
1950	16.52	24.76	121.27	158.54	66.7	13.6	10.4
1951	16.69	28.79	121.89	191.80	57.9	13.6	8.7
1952	22.94	43.42	136.12	194.07	52.8	16.8	11.8
1953	23.09	46.40	130.96	198.14	49.7	17.6	11.6
1954	20.33	42.06	144.70	206.37	47.8	13.9	9.7
1955	20.0	39.80	141.71	219.71	50.2	14.1	9.1
1956	23.69	47.45	154.99	267.50	49.9	15.2	8.8
1957	26.95	47.69	139.05	240.43	56.5	19.3	11.2
1958 E	26.35	61.15	175.39	300.50	43.0	15.0	8.7
1959 E	28.71	61.09	168.41	366.86	46.9	17.0	7.2

E: budget estimates

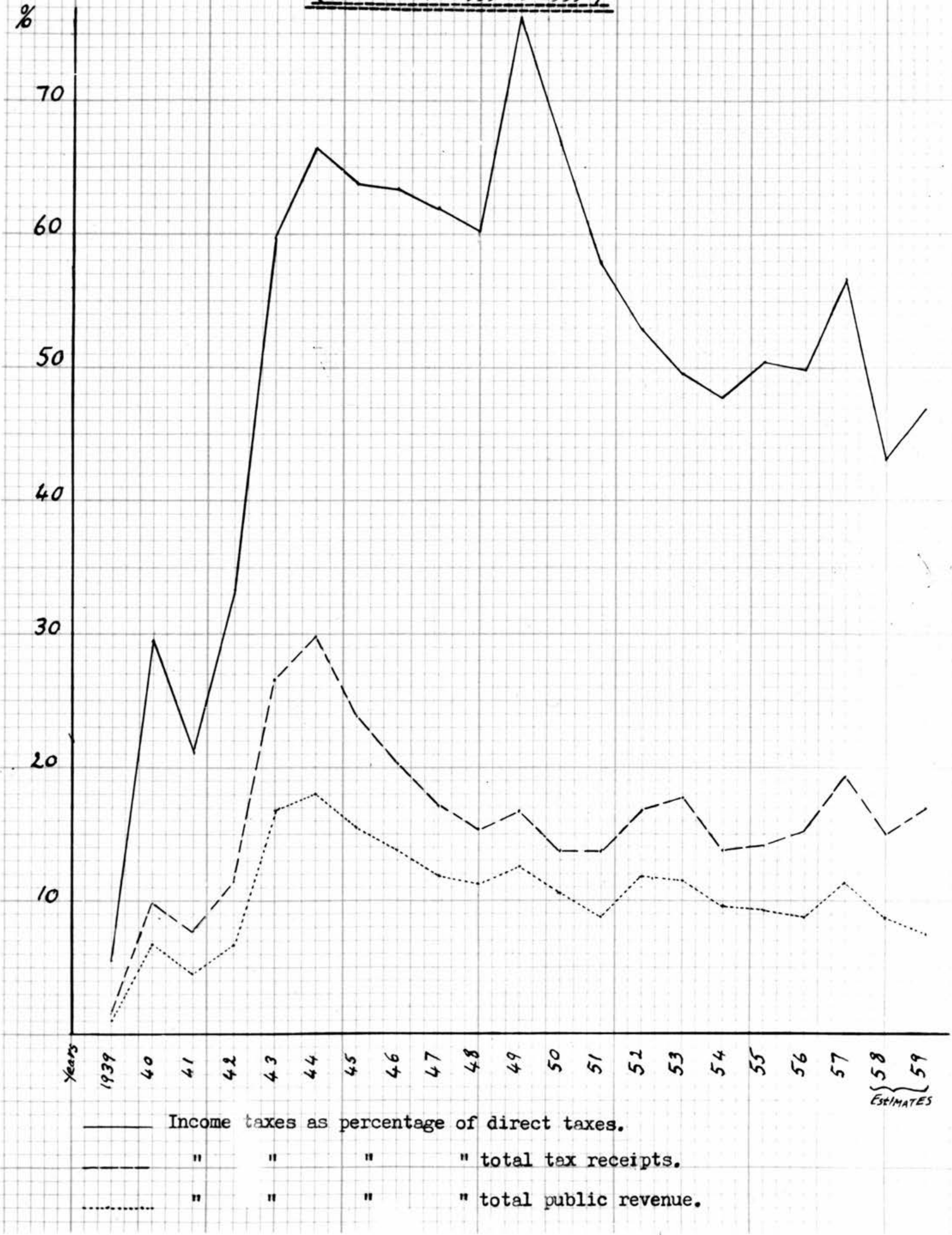
1. Taxes on income include: Schedular income tax of 1939; Excess Profits Tax levied in 1941; and the General Income Tax of 1949.
2. Direct taxes include: taxes on income, taxes on land and buildings, stamp duties succession and estate duties.
3. The fiscal year is 10 months, started 1st May 1947 to 29 Feb. 1948.

Sources: U.N., Public Finance Information Papers, Egypt, 1951; U.N. Statistical Yearbook, 1950, 1955, 1957; Statistical Pocket Year-book, Egypt, 1955, 1957; Budget Report, 1958/59.

FIGURE I.

The Trend of the Egyptian Income Taxes in Comparison with; Direct Taxes, Total Tax Receipts, and Aggregate Public Revenue.

(Years from 1939 to 1959)



Later in 1943 the yield of income taxation started to rise steadily. This was primarily due to the introduction of the Excess Profits Tax in 1942. During the first full year of the Excess Profits Tax, year 1942/43, it yielded £E5.55m. nearly the same amount the Schedular income tax yielded: £E5.79m. The steady increase in the Schedular income tax could be attributed simply to the partial efficiency acquired by the administration as well as to the increase in the tax rate and to the collection of a fraction of arrears. Another fact was that prices and subsequently profits had sharply increased due to the inflationary pressure prevailed during the War period and also during the post-war years. From Table 10 the yield of income taxes during the fiscal year ending in 1949 was relatively higher as the rate of change was about 49% compared to the previous year. The basic reasons behind this apparent increase was the employment of about 600 new tax officials during the fiscal year of 1947/48.[1]

Another sharp increase in the revenue was realised in 1952 which was caused by the introduction and full implementation of the new tax global income which came into being in 1949 but its fruits were available in relatively considerable sums in 1951/52; its yield during that year was £E5.6 million compared to £E1.4 million.[2]

In the fiscal year 1953/54 a decrease in income taxes and revenue was observed as it dropped about £E3m. if compared to the previous year. Such a decrease was apparent in the yield of the General income tax due to the enforcement of the Land Reform introduced later in 1952 and its effect was felt especially on landowners in later years especially in the fiscal year

1. Total tax officials employed in that year was 1823 compared to 1233 in the previous year 1946/47.
2. Statistical Pocket year-book, 1954, Table 48, p. 63.

1953/54 up to 1955/56; during this period the G.I.T. yield was at a standstill in the limits of £E3m.

The general trend of the income taxes revenue importance if compared to total receipts[1] could be easily identified as decreasing in spite of the general steady increase in the income taxes yield. The trend will reach its lowest point in 1958/59 (Budget Estimates) at 7.2%. Nevertheless, it is not quite astonishing to find such contradiction, an increase in income taxes yield accompanied by a decrease in the proportion to the aggregate receipts. The analysis of the revenue items shows that the sharp increase in the receipts during the last five years could be attributed to the increase in the property taxes yield due to the increase in the Building Tax rates since 1956; the increase in the yield being about £E2m. Moreover, the Revolutionary Government, following a planned economy policy, made the Government receipts from public undertakings to increase, due to the increase in the share of the Government in many enterprises. On the other hand, the increase in other receipts paid in return for public services and goods undertaken by semi-autonomous organisations provides an artificial increase in the aggregate revenue. This fact is due to the accounting methods applied in formulating and preparing the Budget. The total receipts of these organisations are included within the items of the different receipts while the expenditures occurred by such organisations are classified under the Government expenditures. The result is in fact a superficial increase in both receipts and expenditures. Therefore, the ratio of income tax yield to total receipts as shown in Table 10 is actually higher for the last two years. Consequently it could just as easily be agreed that it has been constant during the post-war period.

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1. See Table 10 and Figure 1.

Various facts could be deduced from the foregoing analysis which have caused the yield from income taxes to increase; a) the relative increase in the efficiency of administration due either to the increase in the number of employed personnel or to the continuous increase in their capacity to assess and collect the taxes; b) the increase in the tax rate (discussed later) even it might not have a direct effect on the following year's yield; c) the introduction of a new tax, such as the General Income Tax, or the Excess Profits Tax, but on the other hand, the abolition of the Excess Profits Tax in 1950 caused a loss of about £E5m. in the average which was compensated by the yield of the General Income Tax and the collection of a considerable percentage of Schedular Income Tax arrears.

(B) <u>The Flexibility of the Income Tax:</u>

The reaction of the tax revenues to fluctuations in national income is an important phenomenon to the Government. In a depression, revenues are, of course bound to shrink, and in prosperity they are very likely to increase, but the magnitude of these fluctuations in revenues can be anticipated only on the basis of detailed analysis.

Income taxation, personal and business, are easily affected by the fluctuations in the national income if compared with rigid and inflexible taxes such as a property tax levied on the rentals value fixed periodically.[1] A progressive income tax is bound to be more sensitive to fluctuations of national income due to its built-in

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1. This is the case in Egypt regarding the land tax where the rental value is estimated every ten years. The last estimate of the whole country's agrarian land took place in 1948-49. This means that the previous estimation was carried according to agricultural products prices prevailing in 1938-39, just before the War. Therefore the land tax lagged behind the sharp increases in crop prices especially cotton and wheat. Total revenue loss from the land tax could be estimated at £9m. yearly for ten years, a total of about £E90m.

flexibility if compared to a proportional one.[1] The degree of flexibility is, therefore, greater in a progressive tax than in a proportional tax.

The Egyptian income tax system during its first decade of performance was of a proportional nature with the exception of a Schedular tax on wages and salaries. Later in 1949 when the General Income Tax was first imposed the whole structure of the tax gained a farily small rate of progression. Before discussing the built-in flexibility of the Egyptian income tax a few words have to be said about the different types of cyclical flexibility of any tax in general.

The measurement of the cyclical flexibility of the tax revenue is a difficult if not hazardous task, especially in underdeveloped countries where data concerning the national income and the assessment and collection of the tax is scarce and yet if handy it is mostly unreliable because of inaccurate estimation. On the other hand maladministration of the tax system implies a great problem in calculating the proper tax collections concerning a specific year. This is due mainly to the fluctuating collections of arrears.

Two separate aspects are involved in the measurement of the tax flexibility: 1) the flexibility that consists in the capacity of revenues to fluctuate in response to a fluctuating national income at existing tax rates, which technically is referred to as the "built-in-flexibility" of the tax systems, and 2) the flexibility that consistsin the capacity of the tax rates to be modified, with a greater or less ease,

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1. Built-in flexibility is frequently referred to as to denote the relationship between tax collections and other economic variables, particularly money expenditures. With built-in flexibility in the tax system, a pound change in national income results in less than a pound change in disposable income. A personal tax with a flat rate of 20% providing no exemptions increases the tax liability by £200 if income increases by £1000 and thus to a net increase of £800 in the taxpayers's disposable income. See O.H. Brownlee and E.D. Allen, Economics of Public Finance, 1954, pp. 73-75.

by the action of the administrative and of the legislative apparatus, within the generally stable framework of the revenue system. This second conception may be called, for simplicity, the "administrative flexibility".

In the past considerable emphasis has been placed upon the desirability of revenue stability which denotes the relative absence of flexibility. The purpose, at that time, was to protect the governments against the arbitrary imposition of high tax burdens. In recent years, however, a different concept has gained ground, particularly in industrialised countries, which favour built-in-flexibility as a means of compensating fluctuations in national income. If public expenditures are kept reasonably constant, a tax system with built-in-flexibility will produce a surplus during prosperity which serves to check the boom, and a deficit in the depression which could be expected to stimulate the lagging activity.[1]

In order to study the "built-in-flexibility" of the Egyptian income tax, it is necessary to observe actual fluctuations in revenues and to the extent they are the result of administrative and legislative changes in rates, to eliminate the effects of such changes.

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1. R. Musgrave and M. Miller discussed the role of the "built-in-flexibility" of taxes in a compensatory fiscal policy. The main essence of the argument is that the"built-in flexibility" is an important factor in maintaining stability over the long run if taxes in general take a large proportion of the national income. See: The American Economic Association, <u>Readings in Fiscal Policy</u>, pp. 379 - 386.

Therefore, it is possible to establish the relation between national income and the yield at <u>constant</u> tax rates. The period for which data is partially available, i.e. the income tax yield, for studying the built-in-flexibility of the Egyptian system, covering the years 1939-1957 is one of almost constantly rising prices. This data therefore permit an analysis of only one phase of the cyclical trend, the phase of expansion. [1] One cannot say with assurance that during a contraction precisely the same tendencies would be felt in reverse.

It is difficult to measure the "built-in-flexibility" of the Egyptian income tax due to the lack of accurate data concerning the actual tax collections of the various years. But on the other hand, one could measure what we can call "over-all-flexibility", which includes changes in tax rates as well as the introduction of new taxes on income. Table 11 is an attempt to reach such an objective. The data for the years 1939 and 1945 were included just for illustration as the structure of tax systems in 1939 differs from that of 1945 and both from the tax in existance at 1950. But since 1950 we could consider that the income tax system is relatively stable. In other words, no new taxes have been levied on income since; while the Excess Profits Tax was abolished in that year. Income Tax rates, Schedular and General, have been increased during the 1950-1954 period.

The ratio of the income tax to the national income (col. 16), Table 11) fluctuates within two limits; 3% as a maximum and 2.4% as a minimum. To be more precise we have to concentrate on the 1950-1954 period where the income tax structure was constant, (rate changes are taken into account), and thus the range of fluctuation is limited between 2.9% and 2.4%.

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1 . The various types of data either concerning national income or the income tax in earlier years, e.g. 1939/50, could be only considered as "guesstimates". The Division of Statistics in the Taxation Department was established in 1952 and started its real job later in 1953. From my experience in this Department one could say that the only and most accurate data which is produced by the Departmen is that concerning tax collections. This is due to the severe auditing system provided/

TABLE 11

The "Over-all Flexibility" of the Egyptian Income Taxes, and the Tax System as a whole.
(in £E million)

Year	Total Tax Receipts (1)	Income Tax Revenue (2)	Adjusted Total Tax[a] Revenue (3)	Adjusted 5 yr average	National Income (5)	Ratio of Income Tax to Nat. Income (6)	Rate of change % National Income (7)	Rate of change % Total Taxes (8)	Rate of change % Income Tax (9)
						%			
1939	37.62	0.4	42.26	5.04	168[b]	3.0	-	-	-
1945	87.73	13.44	83.19	13.9	504[b]	2.8	+200	+109	+176)
1950	158.54	16.52	161.92	19.9	789.4	2.6	+56	+81	+43)
1951	191.80	16.69	195.61	20.5	860.4	2.4	+9	+20	+3
1952	194.07	22.94	193.03	21.9	748.1	2.8	-13	-1	+7
1953	198.14	23.09	197.85	22.8	780.2	2.9	+4.4	+3	+4.1
1954	206.37	20.13	209.24	23.0	867.5	2.7	+10	+6	+1

Remarks: (a) Column (4) shows the adjusted yield of income taxes based on a five year average. This method of calculation is based on the assumption that the tax assessment time limit is five years (Statute limitation) and therefore the tax has to be assessed before the end of the fifth year; viz. to compute the tax for 1950 we include that year and the four following years and take the average. I believe that this is the most convenient and logical way of calculating the tax as the actual collection (col. 12) does include taxes paid on behalf of other previous years. It is very difficult and almost impossible to figure out the tax collected for the income of a specific year as no data are available. This is due to the lack of assessments and the lack of data regarding the arrears in assessment for each year. Col. (3) is calculated by substracting col. (2) from col. (1) and adding the adjusted yield of Income Tax (col. 4)

(b) Estimates of the national income are abstracted from: M. Anis, "A Study of the National Income of Egypt," Ph.D. Thesis, University of London, 1950.

Sources: U.N.: Statistical Year Books, 1950, 1952, 1957; Public Finance Information Papers, Egypt, 1951; Egyptian Budget Reports, 1957/58 and 1958/59; Statistical Pocket Year-Books.

This ratio could be considered as fairly constant, and this means, in absolute terms, that changes in income tax revenue have responded to the changes in national income. In order to test such an outright judgment one has to calculate the rate of change of the income tax revenue and compare it with the rate of change of the national income. Comparing col. (7) with col. (9), Table 11, we find that when the national income changes at a rate of 200 for 1945, the income tax changes at a rate less than that of the national income, 176 for the same year. This phenomenon is observed in almost every year with the exception of 1952 where the national income decreased while the income tax receipts increased.[1]

(C) <u>The administrative flexibility of the income tax:</u>

The "administrative flexibility" of the tax is mainly caused by the changes in the tax rates and the changes in the efficiency of the administrative machinery of the tax system. The reaction of the tax yield to the change in the rates, i.e. the relationship between the rate changes and the yield, measures the "administrative flexibility.[2] The rates of the Schedular income tax are of three basic categories:

1) A proportional rate for the tax on immovable poverty and for the tax on commercial and industrial profits.

<u>footnote continued from previous page</u> 70:
provided by the Accounting Department of the Treasury and also by the Audit Court. Other data produced by the Department is mostly manufactures and based on aggregation of partial data. For example, if we wanted to know the uncollected taxes at a certain time it would be impossible to provide the accurate figure, as up till now the Taxation Department does not keep individual accounts for each taxpayer showing the amount of tax assessed and that collected every year and the balance unpaid.

1. The decrease in national income was mainly in the Business sector, especially in agriculture where the drop amounted to £E78m. This drop is basicly due to the fall in cotton prices in 1952 and to the political disturbances of that year. This fall in the agricultural sector did not affect the yields of Income tax as agricultural profits are immuned from the tax and that the inelastic land tax is the only tax on agricultural land which was unaffected by this decrease. (Land tax rates are constant for 10 years). For the classification of the national income see: U.N., <u>Statistics of National Income and Expenditure, 1957</u>.

2. The degree of ease or difficulty with which the tax rates can be adjusted could be described, as above mentioned, as "administrative flexibility". The term is used in this context to denote the responsiveness or elasticity of the income tax with respect to given amounts of legislative as well as administrative pressure.

The rate has been always the same for both Schedular Taxes. As a temporary measure the rate applicable to the above Schedule was 7% for the year 1938 (1.9.38 to 31.12.38) and for 1939. The tax was increased to 10% from the beginning of 1940. Later in 1942 the rate was increased for the second time to 12% from the beginning of that year.[1] Eight years later, in 1950, the rate was increased for the third time within a period of ten years to 14%, effective from 1.1.50.[2] The rate became 17% in 1952 and is still at that level up till the present day.[3] 2) A progressive rate applicable to income derived from wages and salaries, starting at 2% on the first taxable amount to £E120 and graduating to 7% on annual income over £E1200.[4] The rates were subject to a change in upper brackets in 1950 where the rates on income above £E800 were increased.[5] 3) A flat rate of 7.5% on the rental value of the practice place of the individual deriving his income from non-commercial professions. The basis of calculating the tax was changed in 1951 and the net income became the taxable base. The rate was then 10% on the net income effective from 1.1.51. In 1952 the rate was increased to 11%.[6]

The general income tax progressive rates were increased in 1952 especially with a higher degree in the upper income brackets.

From the foregoing survey of the basic changes in the rates of the Egyptian income tax system we find it difficult to follow its effect in

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1. Law No. 19 of 1942.
2. Law No. 146 of 1950.
3. The rate was increased to 16% in 1951 by Law No. 174 of 1951 and to 17%, the present rate by Law No. 147 of 1952.
4. The rates are; 2% on the first £E120, 3% on the second £E180, 4% on the following £E200, 5% on the following £E300, 6% on the following £E400 and 7% on income over £E1200.
5. It became 7% instead of 6% and 9% insted of 7% on annual income above £E1200.
6. Basic changes occurred in 1955 concerning the choice of two ways in assessing the tax. See appendix to Part 1.

money terms, on the yield. This difficulty arises from the great diversity of the rates in force and small time lags between the various changes. The tax yield in a specific year could not be recognised as the actual yield for that year, as I have mentioned above, for the huge percentage of arrears and the difficulty of attributing any increase to the change in the tax rate only as there are other factors which affect the yield. These factors are mainly related to the increase in the administrative efficiency of the tax system.

D. <u>The effect of income tax flexibility on the tax system as a whole</u>:

During World War II the Egyptian income taxes receipts increased gradually in money terms. The ratio of income taxes to total tax yield increased at the same time. From Table 10[1] the ratio was 9.9% in 1940 and increased to 29.9% in 1944. This proportion decreased after the War mainly due to the increase in import duties and partially to the relative decrease in business profits. Income taxes are considered one of the most flexible taxes which introduce a high degree of "overall-flexibility" to the tax system. This is basically caused by the fluctuations in money as well as in real incomes and profits subject to tax. While this phenomenon is clearly observed in any income tax, either proportional or progressive, the reverse could be said when considering the flexibility of property taxes based on the rental value. However, custom duties and excise tax are liable to direct government control on the quantity as well as the quality of imported goods which in turn will have a direct affect on import taxes yield on the assumption that the rates are constant.

In underdeveloped countries where indirect taxes, especially customs and excise, compose most of the aggregate tax yield, any moderate change in the yield of income taxes will have a small effect on the aggregate tax yield. An increase of 83% in income tax yield as in 1942 is reflected by an increase in the total tax yield by

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1. Page 63

TABLE 12.

The Yearly Rate of Change in Income Tax, Direct Taxes, and Total Tax Yield.

Year	Income Tax Rate of Change %	Direct Taxes Rate of Change %	Direct Taxes I.T. in %	Total Taxes Rate of Change %	Total Taxes I.T. in %	Year	Income Tax Rate of Change %	Direct Taxes Rate of Change %	Direct Taxes I.T. in %	Total Taxes Rate of Change %	Total Taxes I.T. in %
1939	-	-	5.6	-	1.5	1950	-1	7	66.7	14	13.6
1940	570	28	29.6	6	9.9	1951	1	16	57.9	0.5	13.6
1941	-24	7	21.1	-5	7.4	1952	38	50	52.8	12	16.8
1942	83	16	33.3	27	11.3	1953	0.7	7	49.7	-4	17.6
1943	202	68	59.7	27	26.5	1954	-13	-9	47.8	10	13.9
1944	24	11	66.3	12	29.9	1955	-0.6	-5	50.2	-2	14.1
1945	-4	-0.6	63.8	18	23.7	1956	18	19	49.9	9	15.2
1946	6	6	63.5	24	20.2	1957	13	0.6	56.5	-10	19.3
1947	-7	-5	62.0	9	17.1	1958E	-2	28	43.0	26	15.0
1948	-16	-13	60.1	-7	15.4	1959E	9	-	46.9	4	17.0
1949	60	26	76.3	48	16.6						

Source: Table 9.

27% only.[1] On the other hand an annual decrease of 24% in the income tax yield of 1941 had a moderate effect on the rate of change of the total tax receipts of the same year; 5%. While this phenomenon is observed in many years (Table 12), another contrasting phenomenon is apparent. In various years, such as in 1945, 1947, 1954 and 1957 there had been an annual decrease in the income tax receipts while the rate of change in the aggregate tax yield was positive.

The general conclusion we can derive from the foregoing analysis is that income taxes in Egypt so far had a minor effect on the flexibility of the tax system as a whole from the yield point of view. This, as above mentioned, is due to the dependency of the country's fiscal system on indirect taxation, i.e. customs and excise taxes, more than on income taxes and direct taxation. Nevertheless, the yield from the income taxes has increased more than that of any other tax, especially during the War period and also in the early 1950's.[2] This is partly a result of the progressive character of the tax, especially after 1949 when the General Income Tax was introduced in the income tax system, and the increasing number of persons who have become subject to the tax as money incomes have risen while the exemption limit remained constant during the whole life of the income tax. It is, however, also due to the greater share of profits in the national income, and to the few important reforms in the tax administration.

E. Factors Affecting the Yield.

There are various and diversified factors which affect the amount yielded through

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1. See Table 12.

2. This does not exclude the fact that the income tax yield has decreased in some years while other taxes yield increased. We are only emphasising the general outlook of the trend in the various taxes yield. See Tables 9 and 12.

income taxation. Considering the effects of such factors on the tax yield we could reach the optimum efficiency in the enforcement of the income tax system leaving for the time being the other criteria of efficiency such as economic and social efficiency which will be subject to later discussion.

Therefore our main object now is to elaborate and shed some light on the administrative and partly legislative factors which are closely related to efficiency of the income tax system as a revenue-raiser.[1]

The study of these factors is discussed under three headings, these are: (1) Factors related basically to administrative efficiency, such as: the assessment of arrears, the existing capacity of the administrative power to meet the gradual increase in the number of taxpayers, and the analysis of the cost of tax assessment and collection compared to the actual yield (the maxim of economy); (2) the lack of tax consciousness as in most underdeveloped countries; (3) the widespread illiteracy and also the lack of book-keeping.

Tax evasion and its effect on the efficiency of the tax as a revenue-raiser is considered in less-developed economies mainly as an administrative problem due to the immaturity of the tax consciousness and tax compliance.

(1) <u>Administrative factors</u>:

It is very important to the Treasury to prepare an adequate and well organised administrative machinery when introducing a new tax. In most underdeveloped countries

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1. What is meant here by partly legislative factors are those loopholes found in the tax legislation which affect the proper assessment and collection of the tax and hence stimulate legal evasion, i.e. avoidance. Other legislative aspects of the tax which affect its economic and social efficiency will be discussed later when discussing the equity concept and the role of the income taxes in Egyptian fiscal policy.

the standard of the government administration is low compared to that found in highly developed countries. The deficiencies in the administrative body are mainly caused by the widespread corruption and illiteracy of the majority of the population.

The Egyptian income tax administration suffers from many drawbacks which renders the enforcement of the tax inadequate. The following is a brief analysis of the Egyptian income tax administration. The basic object of the analysis is to elaborate and illustrate the various immarent imperfectionsof the tax administration which affect the tax yield directly and indirectly.

(a) The inadequacy of the assessment and collection machinery:

This results in the ever increasing number of accumulated arrears. In order to give a clear picture of the existing deficiency in the tax assessment it is desirable to state briefly the procedure in assessing and collecting income taxes.[1]

The procedure of assessing and collecting the various Schedular Taxes differs according to the Schedular tax. Firstly, the Schedular Tax on immovable property is assessed and collected at the source and, therefore, no administrative complications are hardly involved. The banks and companies paying the dividends are responsible for collecting the tax and paying it to the Treasury. Secondly, the Schedular tax on commercial and industrial profits is considered the most complicated and difficult to assess. The taxpayer has to submit his return to the Department three months after the end of his financial year and has to pay the tax on the basis of his return a month later; i.e. four months after the end of the financial year. Then the return is checked by auditing the taxpayer's books. Later a notification of the proper taxable income is sent to the taxpayer who has to pay the difference if there is any. If he does not approve of the Department's assessment he has the right to appeal to a special commission

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1. The Taxation Department is responsible for the enforcement and administration of the following taxes: the Schedular Income Taxes of 1939, and the General Income Tax of 1949, the Stamp Duties, the Estate and Succession Duties, and the Excess Profits Tax which was repealed in 1950.

within the Department. Such appeal could be carried forward to Courts of First Instance and also to the Appeal Court. This prolonged procedure resulted in the accumulation of thousands of cases before the courts and, therefore, affected the collection of enormous amounts of taxes.[1] Thirdly, the tax on wages and salaries is collected at source by the employer who is responsible for the tax payment. Such responsibility does not free the employee from the liability; he also shares the responsibility for paying the tax due on his total remunerations if his employer fails to collect the tax.[2] Fourthly, the tax on non-commercial and liberal professions is assessed on the net income. The taxpayer has to submit the tax returns before the end of February and pay the tax accordingly not later than the end of March. In case of disagreement between the taxpayer and the Treasury, the taxpayer has the right to appeal within the procedure above mentioned in the case of the Schedular Tax on commercial and industrial profits. Finally, the General Income Tax is due at the end of April while the submission of the return has to take place not later than the end of March.

From the foregoing survey one could see the various and different procedures followed in the assessment and the collection of the Schedular and the General income taxes which render the administration of these different taxes a difficult task to begin with. In many cases the individual taxpayer is subject to three or more taxes levied on his various sources of income plus the general Income Tax, if his income exceeds £E1,000 a year. This necessitates the filing of several returns and paying

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1. The tax is not collected if the case goes to Courts and the collection is legally postponed pending a final decision.

2. The tax is collected monthly but calculated on a yearly basis. There is a similarity between the British P.A.Y.E. and the Egyptian Schedular Tax on Salaries and Wages concerning the calculation of the tax.

the tax at different times according to the rules and regulations of the various taxes he is subject to.

On the other hand, from the Department of Taxation side every return is checked and verified by a different tax inspector. The result is that co-ordination and harmonization in assessing and collecting the various taxes imposed on a certain individual's income are lacking. This deficiency is mainly due to the tax legislation, but other administrative deficiencies could be recognised as the main cause behind inefficient tax enforcement.

"Egypt's accumulated heritage may be described as a heterogeneous compound of too much economic poverty, personalized government, centralized bureaucracy, inelastic methods, irresponsible civil servants, nonfunctionalization, diffused responsibilities, noncreative task assignments, low production goal, uncoordinated supervision and uneconomical office layouts ....."[1] This description of the features of the existing tax administration has greatly influenced the enforcement of the tax system in general and the income taxes in particular. The outcome has always been delay in assessment and the accumulation of arrears. The following statistics offer illustration of this point.[2]

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1. Quoted from the report on "Egyptian Taxation: the Tax System and its Organization and Administration", by O. F. Traylor, United Nations Public Finance Expert to the Egyptian Government, August 1955, p. 92.

2. The main income taxes which cause a considerable difficulty in administration are: the Schedular Tax on Commercial and Industrial Profits, the Schedular Tax on non-commercial professions, and the General Income Tax. The other Schedular Taxes are basically collected at source.

TABLE 13.

The Lag in Assessment of various Income Taxes, 1951-1955 (Schedular Tax on Commercial and Industrial Profits, Schedule Tax on non-commercial professions, and the General Income Tax).

(The situation as surveyed at 31/3/57)

	Sch. Tax on Comm. & Indust. Profits			Sch. Tax on non-comm. Professions			General Income Tax		
Year	(1) No. of taxpayers	(2) No. unassessed	$\frac{(2)}{(1)} \times 100$ %	(1) No. of taxpayers	(2) No. unassessed	$\frac{(2)}{(1)} \times 100$ %	(1) No. of taxpayers	(2) No. unassd.	$\frac{(2)}{(1)} \times 100$ %
1951	376873	56475	15	20000	8819	44	35618	19932	56
1952	395144	89304	23	20233	10150	50	36069	23865	66
1953	399056	97431	24	20610	11083	54	36430	26342	72
1954	397038	100843	25	20927	12790	61	36425	29209	80
1955	414176	394638	95	20915	17441	83	37456	34236	91

Source: Audit Court, Report on the Egyptian Government Final Accounts for the Foscal Year 1954/55 (in Arabic).

From Table 13 it is very obvious that there are an enormous number of arrears, and this situation has always existed since 1939.[1] To salvage taxes from being unassessed, due to the statute limitations, the Treasury had to seek legislative measures to extend such limitations.[2] In spite of those legislative measures several million pounds of unassessed taxes were legally unrecoverable and became bad debts from the Treasury point of view.

The experience of other countries indicates, in general terms, that "as to the efficiency and completion of tax collection, the latter is greatly improved if the period that elapses between the receipt of income and the payment of taxes thereon is curtailed."[3] This is perfectly true in the case of Egyptian income taxes. During the Second World War, business profits reached their peak and consequently the tax liability increased sharply both regarding the Schedular tax on Commerce and Industry profits as well as the Excess Profits Tax, but the administrative machinery lagged behind and the accumulated unassessed taxes increased tremendously. This state of affairs permitted the extension of the statute limitations several times. The result was that part of the tax on 1943 profits was assessed in 1950 and paid in instalments in later years as most taxpayers were not in a position to pay the accumulated amounts of taxes.

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1. The amount of uncollected taxes was £E11,799,810 at the end of the fiscal year 1949/50 and it has been increasing since. It was estimated that at the end of the fiscal year 1954/55 the amount of unassessed taxes was £E33,471,326. Audit Court, op. cit., p. 38.

2. Tax if not assessed before the end of the fifth year from the elapse of the last date of submitting the return the taxpayer escapes the payment of the tax and legally he has the right not to pay the tax for this specific year. Article 97 Law No. 14/1939 and Article 24 Law No. 99/1949.

3. U.N., Technical Assistance Programme, Revenue Administration and Policy in Israel, First Report, p. 18.

As a matter of fact, many taxpayers disposed of their income either on ordinary consumption goods or on fixed assets and, therefore, cash or liquid assets were unavailable to pay tax debts. Consequently considerable amounts of taxes were lost as several businessmen liquidated their businesses or became bankrupt especially during the few years after the War when the extraordinary wartime circumstances ceased to exist.[1] The outcome of this situation was the unlimited loss of public revenue caused by the obvious inadequacy of the administrative machinery.

(b) The Second major deficiency in the tax administration is the relatively small capacity of the administrative body, i.e. the inadequacy in the number of personnel and their working capacity. In spite of the sharp increase in the number of the Taxation Department personnel, it is believed that such a number is still too low. The following table (Table 14) shows the growth in the number of personnel since 1939 up to 1956.

TABLE 14.

Numbers of the Taxation Department's Employees 1939-1955.

Year	Number	Year	Number	Year	Number
1939	397	1945	1,162	1951	2,318
1940	394	1946	1,235	1952	2,469
1941	478	1947	1,823	1953	2,776
1942	478	1948	1,889	1954	2,772
1943	720	1949	2,044	1955	2,705
1944	790	1950	2,218	1956	2,718

Source: O. F. Traylor, Report on the Egyptian Taxation, op. cit., p. 139.

But in order to obtain a fair judgment of the working capacity of the Department since 1939, we have to compare the amount of tax collections in real terms and the

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1. Bankruptcy after the War rose considerably, from 21 cases in 1944 to 54 cases in 1947 and to 220 cases in 1950. Statistical Yearbooks, Egyptian Government, 1948/49 and 1951/52.

TABLE 15.

Tax Collections per employee since 1939 to 1956 (in real terms, 1939 = 100).

Year	Tax Collections* in £E000's. (1)	No. of Personnel (2)	Collection per employee in £E000's. (1) - (2)	Year	Tax Collections in £E000's. (1)	No. of Personnel (2)	Collection per employee in £E000's. (1) - (2)
1939	400	397	1.00	1948	4,204	1,889	2.22
1940	1,882	394	4.78	1949	6,774	2,044	3.31
1941	1,678	478	3.51	1950	5,846	2,218	2.63
1942	2,378	478	4.97	1951	5,247	2,318	2.26
1943	4,976	720	6.91	1952	7,832	2,469	3.17
1944	5,284	790	6.68	1953	8,453	2,776	3.04
1945	4,846	1,162	4.17	1954	8,224	2,772	2.97
1946	5,389	1,235	4.36	1955	8,431	2,705	3.11
1947	5,399	1,823	2.96	1956	8,741	2,718	3.21

* Tax Collections deflated by the Wholesale Price Index (U.N. Statistical Yearbook, 1957). Tax collections include the various taxes collected by the Department of Taxation, viz. the Schedular Income Tax, the General Income Tax, Estate and Succession Duties, and the Stamp Duty.

Sources: O. F. Traylor, op. cit., and Personnel Section, Department of Taxation.

number of employees. Table 15 shows tax collections per employee since 1939 and up to 1956. The general trend which appears from Table 15 and Figure II indicates the declining capacity of the administrative machinery from the point of view of number of personnel and their capacity. This implies the quick need to reinforce the Department with more working power to cope with the increasing delayed assessment and uncollected taxes. During the last five years under comparison, 1952 to 1956, the administrative capacity of the Department's personnel appears to be constant, an average of about £E3,100 a year per employee.

(c) Collections versus expenditures: the maxim of economy in taxation:

Economy in taxation calls for efficiency of administration. The administrative costs of governments and the book-keeping and accounting costs placed upon taxpayers by taxation should be kept at a minimum. The Treasury should receive as large a portion of tax collections in excess of expenses of collections as possible.[1] The cost of collecting the taxes differs from one country to the other, but generally speaking it is lower in most developed countries than in less-developed countries. In Britain the percentage cost to total gross collections (taxes collected by the Inland Revenue) varied between 1.04% in 1948/49 to 1.33% in 1957/58. Since the fiscal year 1951/52

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1. Data concerning the number of employees engaged in the enforcement of income taxes is unavailable though it is possible to estimate roughly this number by taking the average of employees working in the income tax administration in a sample of district offices in Cairo, Alexandria, Tanta (in Nile Delta) and Asyut (Upper Egypt). Accordingly the average is found to be over 75% of total personnel. The majority of this proportion is engaged in the enforcement of the Schedular Tax on Commercial and Industrial profits.

TABLE 16.

Gross Tax Collections and Expenditures, 1939/40 to 1957/58.[1]

Fiscal Year ending	Tax Collections (1) £E	Total Expenditures. (2) £E	Salaries & Wages. (3) £E	Collections per £E1 expended Cols. 1 & 2 (4) £E	Percentages % Cols. 2/1 (5)	Cols. 3/2 (6)
1940	2,786,257	71,305	46,348	39.1	2.5	65.0
1941	2,719,883	69,250	60,460	39.1	2.5	87.3
1942	4,686,459	87,037	70,145	54.4	1.8	80.5
1943	12,440,902	104,014	86,647	49.6	0.8	83.3
1944	15,482,990	149,248	126,403	103.8	0.9	84.6
1945	15,023,506	210,412	186,877	71.4	1.4	88.7
1946	16,329,825	244,377	210,320	66.8	1.4	86.1
1947	15,496,736	383,850	266,976	40.3	2.4	69.5
1948	13,032,541	449,714	286,545	28.9	3.4	63.7
1949	19,847,172	605,448	458,448	32.8	3.1	75.7
1950	18,706,800	635,716	525,352	29.4	3.3	82.6
1951	18,889,879	853,363	706,659	22.1	4.5	82.8
1952	27,412,566	902,009	786,959	30.3	3.2	87.2
1953	28,150,030	1,006,858	881,185	27.9	3.5	87.5
1954	26,157,380	1,068,840	892,971	24.5	4.1	83.5
1955	27,824,526	1,066,010	935,011	26.1	3.8	87.7
1956	31,994,252	1,201,895	1,029,430	26.6	3.7	85.6
1957	36,291,062	1,292,725	1,142,953	28.0	3.5	88.4
1958	43,690,234	1,363,150	1,197,077	32.0	3.1	87.9
Totals	376,961,990	11,665,221	9,896,766	772.6	2.8 (2)	81.9 (2)

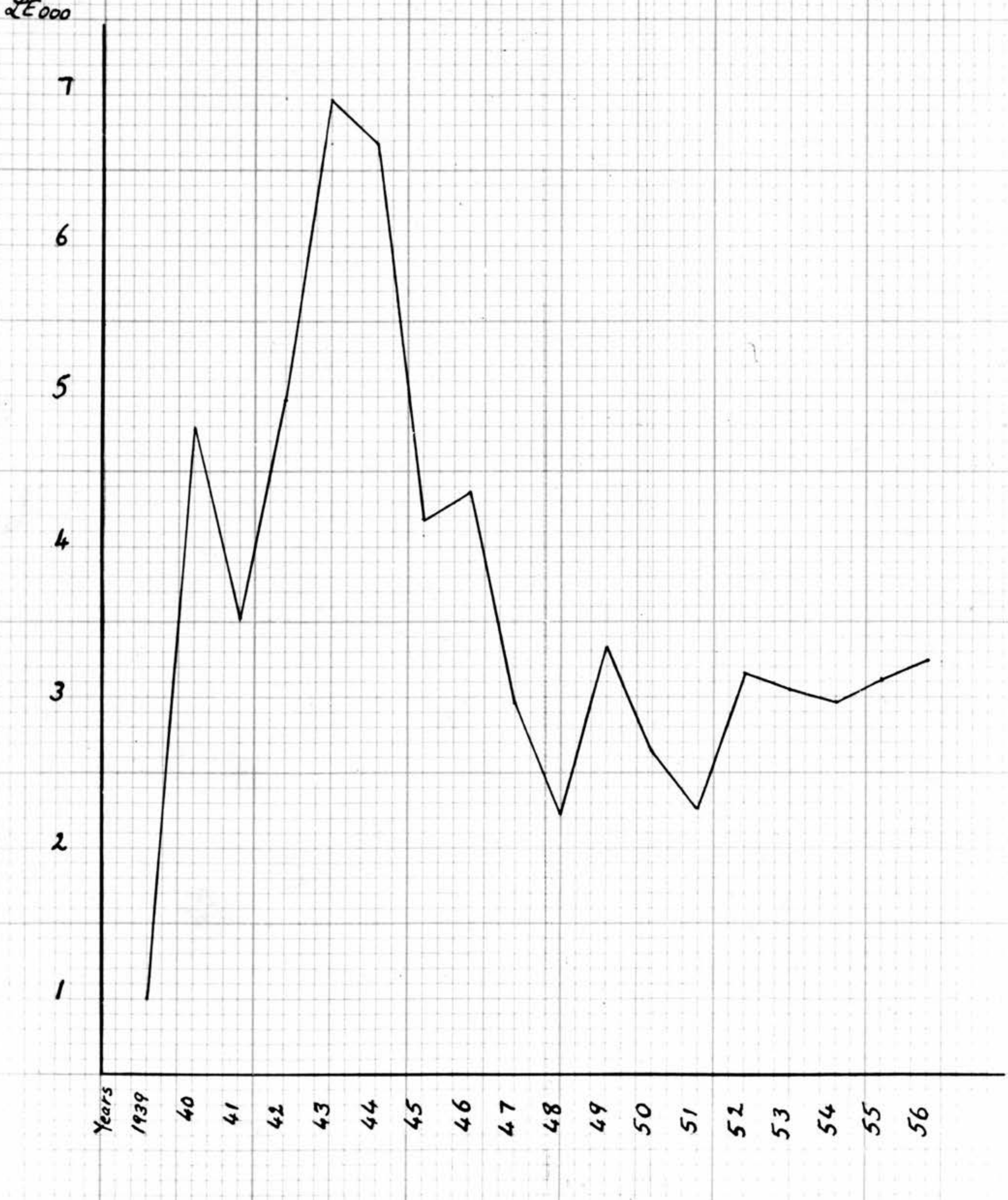
1. Collections and expenditures of the Department of Taxation only.

(2) Ageraves.

Sources: O. F. Traylor, op. cit., p. 136; and Budget Section, Department of Taxation.

FIGURE II.

The Trend of Per- Employee Tax Collections Since 1939 to 1956(in real terms,1939=100)



the tendency was towards the continuous slight increase in the percentage cost of collections.[1] The cost of collecting taxes in the U.S.A. is much lower than in Britain; it was approximately 49 cents per $100 of revenue in 1951.[2]

On the other side, underdeveloped countries suffer from the high cost of tax collection due to the inefficiency of administration and to the low standard of tax compliance, e.g. lack of book-keeping due to the illiteracy of the people ... etc. To take Egypt as an example, from the information provided in Table 16 we can see an agerage performance of requiring around 3 per cent of total actual tax collections to meet departmental expenses over the period 1939-1958. The cost percentage shows a steady decrease for the last four years, 1955-1958. The general outlook of the tax collections per £E expended by the Taxation Department is a decreasing one if compared to the period before 1948, although the present trend, i.e. the last four years, shows a steady increase. In general, this situation suggests that "the Department is not making as good use of its increasing funds for administration".[3]

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1. O. Brownlee and E. D. Allen explained the maxim of economy within the U.S. tax systems that "most simply expressed, economy as an administrative goal means that a minimum amount of resources should be tied up in collecting and complying with any given amount of taxes. Our present complex tax system cannot expect to achieve this goal. Overlapping federal and state taxes mean a considerable waste of resources in the collection of taxes and in the taxpayer effort to comply with ... the taxes imposed on him ..." Economics of Public Finance, p. 201.

2. The latest available data. The cost of collections varied between 89 cents in 1941 and 31 cents per $100 in 1944. See U.S. Treasury Department Annual Report of the Commissioners of Internal Revenue, Fiscal Year ended June 30, 1951, p. 11 and also see, Brownlee & Allan, op. cit., p. 202.

3. Cols. (4) and (5) Table 16 confirm this conclusion. See, O. F. Traylor, op. cit., p. 136.

As mentioned before, about three quarters of total cost of the Department of Taxation expenditure is expended on the enforcement and administration of the Schedular Tax on Commercial and Industrial Profits and, therefore, the collection cost of this tax is extremely high if compared with other taxes. According to the above rough estimate, the cost of collecting that tax varies from 11% as in 1955/56 to about 13% in 1956/57, to about 9% in 1957/58. This percentage suggests the need for a quick revision of the legislative as well as the administrative structure of that tax in order to eliminate the causes of this notoriously high cost. If such causes were eliminated, which is the main element in the relatively high cost of collection of the taxes, we could reach a favourable percentage.

(2) <u>The lack of tax consciousness and tax morality</u>:

Several public finance experts have devoted much discussion to the possibility of controlling public expenditure by making the public "tax conscious" either through the deliberate choice of particular taxes in raising revenue or through the propaganda of private organisations concerning the high costs of government. Governments naturally, try to avoid resistance to taxation by launching a propaganda campaign praising the taxation as a means of reaching over-all social and economic welfare.

Closely connected with the yield capacity of a specific tax is the question of tax consciousness. In this relatively narrow context, tax consciousness means the desirabitity of making taxpayers more or less aware of their own contributions and those of others to the financing of the Government. Since only a relatively small proportion of the total tax receipts in underdeveloped countries, are paid directly by the person upon whom the burden of the tax falls, e.g. the percentage of direct taxes in Egypt is about 30%; tax consciousness is probably not very highly developed in these countries.

It would be unfortunate if lack of awareness of the tax burden should lead to prssure upon the Government for the expansion of public services without regard to the resulting budgetary and revenue problems. But there is no evidence in Egypt of strong pressure in that direction.

The desirability or undesirability of a high degree of tax consciousness is largely a question of what may be called tax morale. Without a certain amount of tax morale, tax consciousness is not an advantage. It is difficult to devise methods of raising tax morality but there are certain factors that undoubtedly affect it, and with respect to those factors wither administrative or legislative action, or both, can be taken.

Generally speaking, the creation and the development of tax morale and ' a sense of tax responsibility ' in Egypt would take a considerable time.[1] But considering the corrupted political and social circumstances which prevailed for over three centuries and also the short experience of the population with income taxes, one should not lose hope that in the relatively near future Egypt will attain a modest level of tax morale and tax consciousness.[2]

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1. P. A. M. Van Philips, Public Finance and Less Developed Economy with Special Reference to Latin America, p. 125.

2. To achieve a modest level of tax consciousness we should eliminate the discrimination among various taxpayers, such as between employees and self-employed. We also need an exact accounting of Government expenditures, not only through the annual report by the Audit Court, but perhaps also through proofs of real performance in the form of public reports and discussions on the Government activities. Finally, a more vigorous prosecution of tax evasion and tax delinquency would no doubt contribute to the gradual improvement of tax morale.

(3) High level of illiteracy and lack of book-keeping.

The high percentage of illiteracy in underdeveloped countries renders the enforcement of the law a difficult task for the Government. Tax laws suffer from such a situation considerably as taxation affects most of the population. Direct taxes, especially income taxes, require a higher standard of education and general knowledge. Therefore, in a country such as Egypt where the percentage of illiteracy is almost about 77% or a little less, the situation becomes alarming if we want to attain a high standard of efficiency in the income tax enforcement.[1] But if we take into consideration the number of income taxpayers in comparison to the total population we find that the percentage of illiterate taxpayers is far below the over-all percentage, as most of the illiterates are farmers not subject to income taxes.[2]

Closely related to illiteracy is the lack of use of book-keeping techniques among a considerable percentage of taxpayers. In quite a few cases where book-keeping exists in Egypt, we find that dishonest and unreliable accounting records prevail.[3] The average businessman in many cases neither keeps organised books nor applied cost accounting with any degree of efficiency. Entrepreneurs in general, other than those in corporations, are not aware of the importance of good administration for the efficiency

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1. The percentage of illiteracy was exactly 77.23 according to the population census of 1947. This percentage is believed to be lower at present due to the expanding education policy adopted during the last decade. See, Statistical Yearbook, 1955/56. Egyptian Government.

2. Data is not available to show the percentage of illiterate taxpayers in Egypt. Most farmers are not subj ct to income taxation either because their income is below subsistence level or because agricultural profits are immuned.

3. In some cases two or more sets of books are maintained. One set is correct and honest which is kept to show the actual profits of the firm, while the other set is dishonestly kept to be presented to the tax officials. This is a widespread phenomenon in underdeveloped countries. See, Van Philips, op. cit., p. 125; and U.N., Taxes and Fiscal Policy in Underdeveloped Countries, pp. 20-21.

of production.

The prevalence of low standard of literacy and the lack of honest book-keeping diminish the yield of the income tax and decrease its efficiency as a revenue-raiser.

(4) Tax Evasion:

This last factor, i.e. tax evasion, is closely connected with the above three factors and actually those factors are considered as elements or sources of tax evasion. Evasion, the sign of administrative failure, curtails tax productivity more effectively than any of the factors previously considered. Tax evasion, breaking tax law provisions outright, may result from legislative shortcomings. No tax law which outrages the sense of fiscal propriety can be well enforced. Twists of taxpayers' psychology assure the easy administration of some taxes and create difficulties in others. Most frequently, however, taxes are evaded because the law has not provided proper administrative machinery or because the organisation and technique of the administrative machine are themselves erroneous.

In Egypt fraud and tax evasion are prevailing in full sway. The people as yet are not taxation-conscious, and this defect accompanied by their hazy understanding of the conception of the State contributes to the widespread evasion. When the Schedular income taxes are first imposed the Government made a very limited effort to explain the fiscal change to the people, but was merely satisfied in promulgating the law. In fact, there are several causes for this widespread evasion; they could be summarised in the following:

1) The deficiency of the administrative machinery to survey and assess adequately all incomes subject to tax;

2) the ambiguous formulation of tax laws and regulations;

3) the instability of tax laws and regulations;[1]

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1. It happened several times that some articles in the Schedular Income Tax Law were changed more than once within the same year, e.g. Art.54 of Law No. 14/1939.

4) the taxpayers' defective compliance with the tax regulations regarding the keeping of honest books and the submission of a correct declaration of his taxable income;

5) the diversity and variety of the assessment procedure;

6) the ineffective punitive methods applied in tax fraud cases; and

7) the abuse of political influence in the past stimulated evasion of certain taxpayers. At present such influence is negligible under the new Regime and the non-existence of political parties.

Several other affiliated social and political factors intensified the tendency towards income tax evasion and, generally speaking, the widespread evasion in Egypt results in a maldistribution of the tax burden, penalising the most conscientious people and those who were liable to pay at source.[1]

It is impossible to estimate even approximately the amount of the leakage of revenue for the shortage of data and the large-scale assessments based on estimates by the Tax Inspectors either because incomes are understated or because of the non-submission of returns.[2]

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1. Another reason, a psychological one, for the widespread evasion, which took place during the last war, was the desire for easy and quick enrichment. Such a pressing desire, accompanied by the understanding that no one was obliged to conceal the means by which he produced his wealth, has driven a large number of taxpayers to fraudulent evasion. The Government in its turn did not meet this sweeping tendency by the swift measures needed, such as intensifying the investigation of the taxpayers' accounts or imposing a capital penalty besides increasing the material penalty on tax evaders.

2. Mr. G. J. Craddock, once an adviser to the Egyptian Ministry of Finance, emphasised his opinion about income tax evasion in Egypt by saying, in his report; "It is obvious from a large number of the estimations I have investigated that a regrettably high proportion of the declarations were not intended to disclose the truth; a constant struggle is in progress between many taxpayers on the one hand who do not keep books of account, or keep duplicate sets of books, doing all they can to conceal the facts, and Mamours (Arabic word for tax inspectors) on the other, who endeavour to construct estimations on very unreliable material, or almost none at all, and yet have to maintain a balance of fairness between the individual and the State." Report upon the Egyptian Taxation Department, Government Press, Cairo, 1948.

In 1954, Mr. Traylor, the U.N. adviser to the Taxation Department, estimated that the tax evasion in Egypt ranges between 25% - 30%.[1] No basis for such estimation could be traced and the writer believes that such an estimate is groundless. In order to estimate the percentage of evaded income and thus the evaded tax we should have the amount of assessable aggregate income which is impossible to obtain at the moment for the lack of data. Also, within the limits of national income data, personal income figures are absent and no attempt has yet been made to calculate these figures.

This brings us to the end of the first stage of our investigation into the performance of the Egyptian income tax. We have examined the income tax system from the view point of its efficiency in raising public revenues. However, in highly developed countries where efficient tax administration and tax compliance prevail, the flexibility of the tax as a revenue-raiser depends basically on two factors: (a) the tax rate; and (b) the size of tax exemptions and reliefs. Both factors affect the tax liability. A decrease in the tax rate implies an indirect exemption of part of the population's income. The difference originating from any reduction in the rate includes a partial exemption of the taxpayer's income if we compare his liability before and after the change. On the other hand, changes in the size of exemptions and reliefs do have a direct effect on the tax base; i.e. net taxable income. By and large the net result in the tax yield depends on the flexibility of the two basic 'tools' of the income tax; the rate and the size of reliefs.

While one could achieve more tangible results in the tax revenue through the 'tools' mentioned in a highly developed society, we found ourselves unable to apply this approach to underdeveloped countries where inefficient tax administration and lack of honest tax compliance predominate. This unfortunate feature has been demonstrated throughout our analysis of the Egyptian income tax system as a revenue-yielder. Therefore, the change

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1. National Income of Egypt for 1953, Ministry of Finance and Economy, Republic of Egypt, 1955 p. 28.

in the tax base on the tax rate through the medium of exemptions and reliefs, does not have the effect intended on the tax revenue. This conclusion raises important matters of policy. In order to make the tax more flexible, administration has to be improved and the various existing loopholes in the legislation have to be covered. The public has to be provided with a clear picture of the public policy and the role of taxation in achieving a better standard of living.

CHAPTER IV

Equity in Income Taxation

I. Introduction:

In Chapter III we have considered the role of the Egyptian income tax as a source of public revenue and now we continue our inquiry into the performance of the income tax from the equity viewpoint.

Equity in taxation has been widely discussed by many economists as well as politicians. But on the whole all such discussions are controversial and do not help very much in practice. However, in popular discussions of the equity concept the fairness in the distribution of the tax burden is usually regarded as an important, if not the outstanding, test of a tax system, and its ability to inspire that confidence in the fiscal basis of government which sustains public morale and promotes productive effort and economic progress. An elementary application of the equity concept requires the equal treatment of persons in similar economic circumstances. But the economic position and circumstances of individuals vary widely, and the range of equity secured by the application of the concept is, therefore, not very wide in its operation. Now the most commonly accepted application of equity is found in the principle of levying taxes according to relative "ability to pay". "Ability to pay" includes and necessitates some degree of progression if fairness in relative treatment of persons with unequal incomes is to be achieved. No formula underlying the scale of progression could be considered equitable from the distribution of the tax burden point of view, as any scale will ultimately include a kind of arbitrariness which in turn renders the tax inequitable. However, the degree of progression depends on the goals of the public policy the Government is aiming at. The degree of progression is usually one of the flexible tools of the public policy which should aim at lessening income and wealth inequalities without decreasing the incentive to invest and to product. In other words a balance should be maintained between economic equality and the incentive effects of the tax system.

The main object of this chapter is to study the equity criterion and its application to the Egyptian income tax. The theme of the analysis is divided into two main sections; first, horizontal equity, i.e. the equal treatment of equals, which necessitates the provision of certain personal exemptions and other reliefs; and secondly, vertical equity of the tax; i.e. the rate system and its progressiveness.[1]

Theories relating to the equity principle, such as the 'benefit theory' or 'ability to pay', have been the subject of innumerable discussions. There is no need to recall these discussions, as they are controversial on the one hand, and on the other, such discussions are, in our view, not very helpful in our analysis.[2]

Generally speaking, the determination of equity in taxation rests to a certain extent, - and we think the forthcoming analysis will demonstrate this -

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1. The question of equity in distributing the tax burden has two major aspects, as aforementioned, but in reality they are two sides of the same coin. See R.A. Musgrave, The Theory of Public Finance, p. 160.

2. For the classical views on the theories related to equity in taxation see the following references: A.C. Pigou, A Study in Public Finance; F.Y. Edgeworth, Papers Relating to Political Economy, Vol. II, London, 1925; E.R. Seligman, The Income Tax; and for English translations of early European economists on this topic, see R.A. Musgrave and A.T. Peacock, (Eds.), Classics in the Theory of Public Finance; International Economic Association, London, 1958; C.F. Bastable, Public Finance. A.De Vite De Marco, First Principles of Public Finance, London, 1936. For more recent revised views based on the classical theories, see R.A. Musgrave, The Theory of Public Finance, New York, 1959; N. Kaldor, An Expenditure Tax; G. Myrdal, The Political Element in the Development of Economic Theory, London, 1953.

upon value judgements relating to the pattern of income distribution which is reagrded as most desirable. Accordingly, the most equitable tax system is that which is most closely in conformity with standards of equity in the distribution of real income which are accepted as most desirable from the society's viewpoint. Any further discussions of the question of equity in taxation must largely involve an exploration of general attitudes towards the nature and the level of an equitable distribution. These discussions are, however, beyond our principal object.

II. HORIZONTAL EQUITY: The equal treatment of equals.

In a welfare economy income plays a significant part as a measure of ability to pay taxes. According to the principle of equity all individuals having the same income and being in the same circumstances; e.g. dependants, nature of the source of income, etc., must be charged the same amount of tax. The implication arising out of this principle might be overlooked if one were careless. The equal treatment of equals encounters several inevitable problems which have to be solved in order to attain a realistic standard of equity between the taxpayers who are within the same income level and within the same circumstances.

Income as a measure of economic well-being and therefore as the tax base has to be defined carefully.[1] But it is difficult to find an adequate definition of income for tax purposes for various reasons, especially

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1. Arguments have been developed to find an adequate measure of economic well being by many economists. Consumption expenditure and wealth were advocated as suitable measures of aconomic well being. As we are interested in income taxation it is desirable to neglect, only for the sake of our investigation which is of primary importance, other measures. For an excellent analysis on the choice of consumption expenditures as a measure of economic well being, see, N. Kaldor, An Expenditure Tax.

especially if we have in mind other definitions of income ~~tax~~ conception of various economists, classical and contemporary.

(A) The Tax Base; The Income Concept:

What is meant by income? The answer to this question is the usual outset of this study. Different economists define income in general terms and others define it from the taxation point of view, Several definitions of income were offered by several economists from time to time. But such definitions should not be interpreted as suggesting that taxable income, apart from ordinary income, rests on any well framed academic formula. The differences in the definitions applied "are due to different conceptions of the nature of income, constitutional limitations in the legislature, political or economic considerations, and conventions with other countries."[1] That does not mean that academic concepts have had no influence in determining any practical income formula. In reality, they help to clarify the confusion in legislation about income and make it easier to differentiate between the product and its source in a way that does not hamper the process of the economic machinery.

Income could be defined as a persons consumption plus the increase in his wealth during a specified period; or in other words consumption plus savings. Consumption should include services as well as commodities, and savings should not include the inherited or bequeathed wealth.

Strictly speaking, income as contracted with capital denotes that amount of wealth which flows in during a definite period and which is at the disposal

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1. H.B. Spalding; The Income Tax in Great Britain and the United States, p. 19.

of the owner for purposes of consumption so that, in consuming it, his capital remains unimpaired.[1]

A general definition of income is hard to attain, therefore it is always difficult to reach a complete perfection within any definition. Income, in absolute term, could be defined as the flow of services and commodities during a certain period, which is usually a year.[2] These services and commodities should be measured by an acceptable medium - such as money. To make this definition more sound within the framework of taxation, e.g. income taxation, and to prove it is both conceivable and practicable the following basic criteria have to be elaborated:

i. Psychic income and income in kind;
ii. Income as a separate entity from capital;
iii. Gross and net income;
iv. Time concept.

i. Income in kind:

To impute the actual income of a person, money income as well as income in kind has to be taken into consideration. Income in kind in many countries comprises an important part of the individual's aggregate income. In a less-developed economy, where the non-monetary sector is large, income in kind in the form of home-consumed agricultural products constitutes a large proportion of the country's national income. In a highly industrialized country income in kind in the shape of free recreation centres, free or cheap meals supplied to workers, free transportation and health care etc., are considered of relative importance especially

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1. E.R. Seligman, The Income Tax, p. 19.
2. A.C. Pigou, op. cit., pp. 77 - 78.

in computing taxable income.[1]

Two opposite arguments are involved in the liability of income in kind to taxation; the first is against the inclusion, i.e. the exemption of such income from the tax base; and the other is in favour of its inclusion. Exclusion has been defended on the grounds that such income is in fact a part of special compensation for unfavourable working conditions and that these services and commodities offered to the employee, within the industrial sector in particular, are not what he would like to obtain if he is left a free choice.[2] The advocates of the inclusion of such income founded their reasons on the basis that these services and commodities are rendered free or at a low price, which the employee otherwise has to purchase from the free market at a higher price. Therefore, the difference between the market price and that paid by the employee should be taxable as a part of the individual imputed income.

One of the basic problems is the difficulty of evaluating such income. What is the value of free community facilities when there are comparable public facilities which are better? What is the value of a three-shilling lunch to someone who would ordinarily buy a two-shilling meal?

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1. Under the influence of a more scientific approach to worker psychology and motivation, industry has realised that productivity of the worker is influenced by many factors other than his wage or working hours. The employer's interest in the worker as a person has often been more of a spur to the worker than an increase in wages would have been. In addition to aiding the employee morale certain fringe benefits are aimed at increased production through decreased absenteeism by free or reduced-price meals, living quarters, free health services, recreational benefits and the like.

2. W. Vickrey, Agenda for Progressive Taxation, p. 35.

Connected with this problem of assessment and evaluation, is the difficulty of collection, from the atandpoint of both the employer, who presumably will have to withhold for many of these benefits if taxed, and the revenue authorities. The administrative difficulties often become prohibitive as these benefits could not be assimilated to the payroll where the number of employees who receive or use the benefits varies from month to month.

A third, and most significant, administrative consideration is the amount of revenue which can be collected. If the cost of evaluating is larger than the revenue, the government should not make an effort to tax.

The following basic non-conclusive criteria should be considered in imputing income in kind subject to taxation:

a) The extent to which the employer and the employee consider the benefit to be a substitute for each payment.

b) The extent to which the benefit is actually or potentially a substitute for an expense which has otherwise been incurred.

c) The extent to which the employee has freedom of choice with regard to the service or commodity.

d) The extent to which the benefit is available to a specific class of employees.

By and large, each type and even each case of these benefits has to be studied separately as it sometimes is difficult to set up a general rule. This resolution is unattainable for its impracticability and for its administrative difficulty, and therefore, some degree of arbritrariness might be involved in any alternative resolution.[1]

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1. The writer believes that it could be possible for the revenue authorities to set up schedules for the evaluation of income in kind taking into account the above mentioned four basic controls.

To ignore the inclusion of 'income in kind' or even 'leisure income' in the tax base will serve to increase the real exemptions and also the effective degree of progression.[1] Moreover any discrimination against the inclusion of income in kind in the tax base could easily facilitate avoidance and most probably evasion.

Consequently, it is very important to eliminate unwarranted exemptions involved in evaluating and considering the taxability of any service or commodity offered in kind to taxpayers in order to achieve equity in the distribution of the tax burden.

<u>Income-in-kind in an underdeveloped economy</u>:

A closely related problem to the above analysis is the predominating factor in many underdeveloped countries where non-monetary transactions take place in a sort of primitive economic conditions. Barter trade and payments in kind, viz. to workers, is of widespread character for the lack of inefficient and very limited monetary institutions in such countries and also for the high level of illiteracy between the people.

As most underdeveloped economies are mainly of agricultural nature and therefore the majority of the population is engaged in farming, it could be easily emphasised that most of the farming population, who are just agricultural labourers, enjoy an income around the subsistence level due to the low income

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1. Simons wanted to tax 'leisure income' as he stated "income for consumers' capital is often a large part of total income for individuals in the upper brackets". Its inclusion would introduce a bias inconsistent with the system of progression, differentiating against people of similar financial circumstances and opening the door for evasion. This view might be important when direct employment is more urgently required to balance the economy of the community. But Simons does not provide any accurate measure to calculate this 'leisure income' for taxation. See, H. Simons, <u>Personal Income Taxation</u>, pp. 113 - 14.

per capita and to the unequal distribution of personal income. Accordingly the subsistence farmer cannot be satisfactorily reached by an income tax because the greater part of his real income cannot be adequately and efficiently assessed. It has been stated by the United Nations experts that "even highly skilled administrators have made little progress toward including the value of home-produced and consumed foods in the taxable income of the farmers".[1] It is believed that these groups which make up for a major fraction of the population are usually the poorest of the society, and the failure to tax them "may not be seriously objectionable from the equity point of view".[2] Besides, it would be uneconomical to collect taxes on their income as the tax yeild would not compensate the cost of collection from the administrative viewpoint, if ways and means were discovered to assess the tax feasibly.

Other taxes, however, might be able to reach such income. But such taxes might include an element of arbitrariness which violate the equity principle. A poll-tax, for example, might be the only solution in this context for the simplicity it involves in its administration. The poll-tax here, would ignore the relative differences in income and civic circumstances, e.g. dependents, etc. But on the other hand one could easily say, with caution, that the farmers' income in an underdeveloped country does not vary widely from one person to another as the majority of them enjoy income; cash income and income in kind; below or just around the subsistence level.

In order to make the proposed poll-tax relatively equitable regarding the differences which exist in the civil conditions; dependants, we could

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1. U.N., Taxes and Fiscal Policy in Underdeveloped Countries, New York, 1954, p.20.
2. Ibid. p.20.

simply allow a deduction from the tax of a small fraction for each dependant. The administrative feasibility of this tax is its basic advantage.

ii. <u>Income distinguished from capital</u>:

Income as a tax base should be clearly distinguished from capital, but a clear cut distinction might be hard to attain. An ideal income tax should interpret clearly what is income liable to taxation and if any doubtful items are included these must be stated in the legislation without any absurdity or hesitation.

Income distinguished from capital, should bear the label of continuity. This rule is not always applicable as there are items which could be regarded as capital but are income in reality, e.g. speculative profits, other capital gains, windfall gains, etc.

Capital on the other hand, is recognised as that part of wealth or property that at a given time is employed in the production of future goods, and, therefore their production function is their main character.

However, one can describe income as the net product of capital. This product could be an incorporeal or material one. The former is obtained from the possession of commodities such as pieces of art, pictures, antiques and precious stones, while the latter is derived from labour, money producing assets, the consumption of durable goods and other assets.

Consequently, in the science of public finance, we can consider income as the net accretions to one's economic strength which could be measured by money or other means, during a specific period.

There are, in most cases, three basic characteristics which distinguish income from capital:

a) Income usually accrues periodically, like the trees which bring fruits each year, but this is not always true, e.g. the case of a person who buys a certain amount of securities or other commodity with the intention of selling them and then sells his stock at a profit: therefore, this profit could be considered as income liable to taxation, even if profitable transaction occurs once and for all.[1]

b) Durability of the source of income is another major principle derived from the first one, the principle of productivity. This as long as income accrues periodically the source should be in existence. The income source may take one or more of the following shapes; 1) Corporeal sources such as buildings, land and other tangible sources; 2) incorporeal sources such as business goodwill, shares to bearer; or 3) the source might be non-materialistic such as personal talents, physical strength and the like.[2]

c) The maintenance of the source is important for its productivity; therefore, the acquisition of income requires continuous care paid for the restoration of the source in order to guarantee its periodical productivity and thus to distinguish income from bequests, windfalls and inheritance. On the other hand maintainance cost of the source depreciation must be taken into account so as to accumulate a reserve for the replacement of the asset in the case of wear and tear, or obsolescence.

A difficulty arises from any definition of income as a separate

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1. Periodicity of the income subject to tax has been denounced as an important criterion in defining taxable income; this was clearly stated in the Minority Report, (Memorandum of Dissent), Royal Commission on the Taxation of Profits and Income, Final Report 1955, p. 358; as follows "The old boundary-line afforded by the regulatity or recurrence criterion has been discarded in judicial decisions (in Britain) which have established that casual or isolated gains are taxable provided that they are not of the character of "capital profits"."
2. Seligman made it clear that "neither the permanence of the source nor the regularity of the receipt any longer forms a necessary part of the concept of taxable income." Encyclopedia of Social Science, Art. Income Tax.

entity from capital; capital gains for example is neither an income nor a capital, so what is the fiscal treatment of such gain? For the importance of the question of the taxation of capital gains and losses, an investigation in this dilema within the fiscal structure has to be attempted. What kind of fiscal treatment should such gains receive in a less-developed country? Our analysis of this question will be confined to its relation to the equity principle.

We consider that it is important to discuss the taxation of capital gains and losses especially in less-developed countries. The discussion of this question had therefore to be tackled from all angles as the fiscal treatment of capital gains and losses does have a direct effect on the economy, where economic development is of the utmost importance. This is the reason why this part of the theoretical analysis is lengthy.

Capital gains and taxable income:

There has been considerable discussion of whether capital gains and losses should be included in income for taxation, or exempted.[1] Capital gains and losses occur when a person sells for a profit or loss what is ordinarily retained as a source of income. More specifically, they arise as a rule when an owner sells real estate or securities. They may also occur when the owner sells a factory or a machine.

Various arguments have been developed in favour of and against the inclusion of capital gains in taxable income. Any reason for the inclusion could be met by a counter-reason for the exclusion. Most arguments on this subject

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1. For a comprehensive discussion of the problem of capital gains taxation, see Royal Commission on the Taxation of Profits and Income, Final Report (Memorandum of Dissent) pp. 365 - 382, Cmd. 9474.

are highly controversary and need therefore a careful analysis regarding the economic effects and administrative problems encountered in any results obtained from such analysis.

The principle reason for the taxation of capital gains is that the capital gains increase the power to spend and to save of the individual and hence increase his taxable capacity. Capital gains are usually concentrated and distributed among small portions of the community and therefore, the exemptions of such gains, which are considered as an increase in the economic power within a specific period, would result in a severe violation of equity. This treatment is considered as "a serious discrimination in the tax treatment of a particular class of tax payers."[1] Consequently the basic argument for the taxation of capital gains rests on the equity principle.

On the other hand, the main arguments habitually used in justifying the exclusion of capital gains from taxation are:

1) Capital gains might be illusory due to an inflationary trend in the economy and therefore such gains do not represent real gains. The taxation of such illusory gains means the over-taxation of a special group of taxpayers, and this in turn conflicts with the principle of equity.

This argument could be easily counter-attacked on the basis that taxable capacity is principally a relative concept. Therefore, property owners who realise capital gains during an inflationary period are "in a better position than those who own fixed interest securities".[2] From the equity point of view

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1. The particular group of taxpayers in this connection are mostly property owners, real estate owners, owners of equity shares and the like. Ibid., p. 365.
2. Ibid. p. 366.

any exclusion of capital gains made during an inflationary period is a strong violation as changes in the relative taxable capacities of taxpayers are ignored.

2) Any fall in interest rates might result in illusory capital gains to some investors and therefore, if such gains are taxed this would cause injustice as such gains are not real and do not increase the investor's future income.

To meet such objection, the appreciation of capital values due to the fall in the interest rate does represent a real gain to the property owner and therefore, it increases his capacity as an individual to spend and to save. His taxable capacity, however, is stronger than others. Furthermore, the experience, as Kaldor and others emphasised,[1] that periods of falling interest rates alternate with periods of rising interest rates and the result is a little net change on balance.

3) The irregularity of capital gains excludes it from any sound difinition of income concept and accordingly it does not represent the same taxable capacity as a regular income.

As mentioned above, any increase in the taxable capacity due to the realisation of capital gains does increase the economic power of the individual to spend and to save. The ultimate aim is the measurement of the taxable capacity of the individual in a specific period in order to assess the appropriate tax on his total power or ability. In other words capital gains do increase the individual's command over goods and services within a given period. Any failure to tax such excess taxable capacity represented in the increasement in the economic power is not consistent with equity.

4) The administration of any tax levied on unrealised capital gains seems

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1. Ibid. p. 367.

unfeasible and also unequitable.

For practical reasons any tax on unrealised capital gains is extremely difficult to administer. I believe that this reason is of fundamental significance for not taxing unrealised capital gains even if it might be due to the appreciation in the value of capital assets and the failure to include such appreciation in the taxable capacity is a breach of equity principle. In many cases equity is violated for practical reasons beyond the control of human beings and therefore, to exempt unrealised capital gains from taxation would not be strongly opposed by other taxpayers on one hand and by the government on the other.

According to the principles of business accounting account must not be taken to include accrued gains into taxable income until they are realised.[1] But, the taxation of realised capital gains only means the postponement of liability as compared with taxation based on accrued gains since property owners may not realise some of their assets during their lifetime at all or not for some years after the appreciation has taken place.[2] In fact a basic argument against the taxation of either realised or accrued capital gains is that such gains might have occurred during several years and to assess the tax within a specific year where, for example, realisation has taken place does mean the overtaxation of the individual and thus infringing the equity principle. Consequently, a practical device has to be discovered in order to average these gains over the period during which the appreciation in value accrued.

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1. This principle has an exception especially in the valuation of inventory at the end of the trading year according to the principle of "cost or market value whichever is the less", and therefore unrealised losses are taken into account when stocks are valued at market prices, when market prices are below cost.

2. Ibid. p. 372.

A further argument could be developed if unrealised capital gains are untaxed; the individual might be able to arrange the realisation of capital gains as well as losses so as to avoid the tax or minimise its effect to a great extent.

These arguments, the pros. and cons.; to include or to exclude capital gains and losses from taxation does leave the reader in a hesitating state and renders the job of making one's own mind reach a decision which sounds feasible and expedient from equity as well as economic efficiency point of view, very hard.

Before an attempt is made to reach any decision we have to discuss very briefly the economic effects of taxing capital gains.

The main economic argument against the taxation of capital gains, realised or accrued, is that it does discriminate against risk-bearing, saving and capital formation. Under a progressive income tax the charging of capital gains at the full rate as ordinary income would have an effect on the incentive to save and encourage capitalists to dissipate the capital.[1] In general, according to this argument, property owners who make capital gains will do their best to evade, or avoid, the tax or at least for the new investors not to invest their savings in risky ventures.

A second important argument is that a capital gains tax is necessary in an inflationary economy. A capital gains tax will reduce the boom spending because it reduces the extent to which an individual's position on capital

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1. Ibid. p. 374; and also N. Kaldor, <u>An Expenditure Tax</u>, p. 114 - 115. Under the British income tax, for example, if capital gains were subjected to both the standard rate and surtax rates, the effect would be that a great part of these gains is taxed at an extremely high rate, e.g. 17/9 in the £.

account is strengthened by the boom. This argument is attacked by the allegation that capital gains, on the whole, are saved during the boom as most property owners enjoy a high income and need not spend such gains. Therefore, the taxation of capital gains would not be effective in controlling the inflation. This allegation seems groundless to some extent, as many individuals who realise capital gains during the boom do come from the middle and upper-middle classes as well as the high income groups. Thus the tendency to spend their gains is high and consequently such expenditure would increase the inflationary pressure. The degree of effectiveness on the inflationary pressure depends on the aggregate amount of net capital gains realised during the period under investigation.

In a developed economy, a highly industrialised one, the amount of net capital gains is far greater than that in a less-developed economy where
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the individual sector is relatively small. On the other hand real estate owners in underdeveloped countries have realised considerable amounts of capital gains due to the rise in the level of prices during and after the Second World War. In most underdeveloped countries capital gains realised from the sale of capital assets, apart from the sale of business assets, are not subject to income tax.[1] The immediate effect of this tax exemption is to favour speculative transactions as against ordinary productive investment. Sometimes this form of speculation may be beneficial to the economic process of production and distribution, even though investment aimed directly at these purposes would normally be more effective. At other times speculation may be downright harmful, as for instance during the

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1. Reviewing the recommendations of Selected Technical Assistance Missions of the United Nations, it is observed that most countries visited by these missions do not tax capital gains especially those realised from speculations. See U.N., <u>Taxes and Fiscal Policy in Under-developed Countries</u>; pp. 43 - 111, New York, 1954.

war years, when it served to accentuate the inflationary pressures. At such times, some anti-inflationary effects might have been produced through the imposition of a capital gains tax. A capital gains tax, moreover, would help somewhat to redress the increasing inequality in the distribution of income and wealth that usually accompanies inflation. On the other hand a capital gains tax in an under-capitalised country, as most underdeveloped countries are, might have an adverse effect on capital formation. Therefore, it may be wise, in these cases, to avoid interfering with the process of capitalisation even at some sacrifice on other respects such as equity.

While exemption of capital gains of speculative nature might be beneficial, we should try to tax gains realised from the transfer of property, e.g., buildings, land, and other tangible assets. Some countries already tax these gains through a tax on the transfer of the property either through sale, gift or at death. "The Danish practice of periodically taxing the increase in value of land was commended as an example which might well be followed in underdeveloped countries, especially where values of properties rise due to public works."[1] However, a net worth tax based upon the sales value of the assets is also another alternative of property taxes in reaching capital gains.

Finally, from the foregoing analysis, it is believed that the taxation of capital gains through direct tax or through another medium such as a tax on the transfer of property, is not undesirable for accomplishing specific economic or social goals in an underdeveloped economy. Therefore, we should not depend on a capital gains tax for raising revenue but only as a <u>regulatory tax</u>.

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1. Ibid., p.35.

The question of administrative feasibility is of great importance in an underdeveloped country where maladministration predominates. But the inefficiency of administration should not stop or hinder the government from levying the tax on capital gains realised from the sale of real estate, and not from speculative ventures,[1] if the government sees that there is a pressing need for such tax to reach a certain social or economic objective.[2]

On the other hand, speculative capital gains should not be completely exempted. Capital gains of this nature should be taxed if it becomes a habitual act to the individual and therefore it should be recognised as income derived from his job as a speculator in the stock market, for example. What we should stress on is not to create a disincentive element for investment in underdeveloped countries where capital is scarce and initiatives or stimulants have to be chanelled to stimulate investment. Therefore, any capital gains tax on the appreciation in the value of securities, especially in the case where the majority of shares are owned by the natives, will have a disincentive effect to invest, even if such treatment conflicts with equity.

iii. Gross versus Net Income:

Income as a measurement of equality between taxpayers is a misleading medium unless we find the relationship between the aggregate amounts received by the person during the period, and the amounts comprehend net gain to him. Therefore adjustments must take place in the amount of gross income to acquire

1. By speculation in this context is meant that type of speculation which takes place everyday in Stock Exchange dealings in shares and other securities.
2. Taxation normally is not directed to real values; it is always levied in terms of monetary amounts. Therefore, there is no justification for exempting inflationary, as against other gains on income. In fact all incomes in an inflationary period are inflated, whether they are derived from sales, from services or from work, with the exception of fixed income such as civil servants, etc.

net income. According to all tax legislations, deductions are allowed for various items in order to arrive at true net income which represents the real gain or the net increase in the individual's economic strength during a specific period. The determination of net income involves two major problems. The first is the differentiation between expenditure necessary to earn income and consumption expenses. The second is the allocation of expenses among specific periods.[1] Changes in the price levels will likewise involve a difficult problem in computing net income through the evaluation of inventory or, in dealing with depreciation and depletion allowances.

Briefly, it is rather difficult to differentiate between expenses necessary for earning income and those for consumption or, in Vickrey's words, "whether the return on the expenditure will be a direct non-taxable service to the individual or will be in the form of taxable income."[2] However, the revenue authorities should find an appropriate solution by dividing these expenses into classes for every type of business or profession. This solution is not simple to administer and would include arbitrary elements to a limited extent. But it is the usual practice in most income taxes that government tries to set up the necessary regulations in order to distinguish between the two types of expenses as adequately as possible.

The second problem relates to the principles of accountancy. Some business expenses, such as advertising expenditures; business establishing expenses occuring during the pre-production period, and other similar expenses, prove to be useful for the establishing and the flourishing of business for several

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1. J.F. Due, Government Finance, pp. 161 - 165.
2. W. Vivkrey, Agenda for Progressive Taxation, p. 121.

years. Thus such expenditure must be allocated among the various years during which the business has benefited.

Another problem related to the allocation of expenses is the allocation of depreciation allowance of capital assets and equipments are usually used for more than one year; therefore, its cost (depreciation charge) must be distributed among the years during which the asset is technically useful. Taxation laws should, as far as possible, ensure that the enterprise or the individual property owner is not taxed upon the capital but on the return.

iv. Time Concept:

The time concept is an indispensible criterion in determining taxable income. It is observed in almost all income taxes that income is usually appropriated into one year periods, and that each year is assessed independantly of the previous years. This generalisation should be modified as many income taxes admit the deduction of previous losses from the current years profits or carrying back losses to be deducted from previous profits. The carrying back and forward of losses is an acceptable proceedure in modern fiscal systems as an incentive as well as a relief for business. Moreover, the deduction of losses from profits does coincide with equity considerations on the basis that the taxpayer should be able to average his profits over several years in order to reach his real ability to pay, i.e. his true taxable capacity.

One of the basic problems in determining the period of taxable income is fixing the time during which income is considered to be realised or created. Profit or loss realisation provides that such loss or profit has occurred and are tangible. Therefore, any gain or loss accrues during the taxable period which is limited by the liquidation of the business, should be taken into account in imputing the tax.

The time concept also effects the method through which the inventory is to be valuated. Methods of inventory valuation are mainly connected with accountancy. If prices of goods purchased or produced change during the fiscal year the problem of the evaluation of goods in stock at the end of the year arises.

The assessment of the income tax on a yearly basis involves in many cases tax avoidance by providing a chance for shifting part of income from one year to another. This is quite clear in the case of undistributed profits and in cases concerning the calculation of depreciation and depletion.

Within a progressive tax system, the individual whose income fluctuates from year to year will be taxed heavier than another person whose income is the same in the average but distributed mote evenly. As a result of income fluctuations under a progressive rate, a progressive income tax creates an unjustifiable distribution of the tax burden as the ability to pay of the individual with a fluctuating income is the same as the other who enjoys a steady income though the first pays more taxes than the second.

The solution of this problem is to give the taxpayer the option of recalculating his tax liability over previous years and taking the average as the

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1. W. Vickrey, op. cit., p. 166.

taxable income for each year.[1] Thereafter the taxpayer could apply for a refund or credit of this difference between the tax computed according to this method and that actually paid. This method seems impracticable and far beyond the administrative feasibility in underdeveloped countries, due to the inefficient tax administration.

To conclude the analysis of the income concept, any theoretical definition is usually different from what is actually found in practice.[2] In most cases, the practical definition is formulated according to various factors depending on political, social as well as economic conditions.

In practice, many income tax laws do not define clearly the concept of income, but they do define in the legislation and interpreting regulations what is the gross income and what allowances and reliefs are deductable from the gross income to reach the net taxable income. This is the case in Britain, France as well as in Egypt. By and large the elasticity of the income concept, as a tax base, is an important and effective device in the hands of the Government. It can be and is used to accomplish various economic and social objectives.

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1. See H. Simmons, Personal Income Taxation, Chicago, 1955, p. 154. Another method has been developed by W. Vickrey known as the "Cumulative method". The main structure of this method is that at the end of each year the taxable income of the current year would be added to the cumulative figure of income from the date the individual started earning his income or from the date of the establishment of the enterprise. Under this method the tax burden remains independent of shifts within a specific period called the 'averaging period'. But, on the whole, this method does not curtail the effects of non-responsiveness of the tax yield to changes in either incomes or tax rates. The main disadvantage, therefore, of the "cumulative method" is that it lags behind any effective fiscal policy implemented in the boom or depression. In inflation, for example, this method would not be of any tangible significance in absorbing the excess purchasing power. See. W. Vickrey, Agenda for Progressive Taxation, pp. 172 - 195.

2. Income according to Simons "would be readily and accurately measurable only in a world where goods and services fell nearly into a small number of homogenous classes." C.F. Simon, op. cit., p. 103.

Factors affecting horizontal equity:

Civil status, temporary and permanent income, dependants and various other factors have a substantial impact on the distribution of the tax burden between individuals injoying the same amount of income. The following is a brief account of these important factors which are indispensable if we want to reach an equitable treatment of individuals according to their real ability to pay.

a) Civil status: A bachelor with the same income as a married man is obviously in a better position. Therefore, a married person has to be favoured regarding his income tax liability. When we are faced with the problem of measuring the difference between these two persons, the basic question is what amount of taxes should a married person pay as compared to that payable by a bachelor?[1] A married couple with no dependents living together have a taxable capacity greater than that of a bachelor having half of that income as it is cheaper for a couple living together than a bachelor living alone who has to hire a person for domestic help which is usually free in the case of a married couple.

Statistical data have to be provided in order to obtain the required results; i.e. the cost of living of various income groups in the community under consideration, amount of income sufficient to satisfy the normal needs of a bachelor within a specific income group and the relative income for a married couple with no dependants, the net income after taxation in each case, and if the tax provisions include the domestic work of the housewife in the taxable income or not. If it is not included, do these provisions offer a special allowance for a housewife in

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1. W.J. DeLangen, "The Assessment of Members of one Household", Public Finance, Vol. XI. pp. 130 - 145.

the case of an unmarried man, e.g. a divorcee or a widower?

Generally speaking, all these details should be taken into consideration whenever the question of equity in the treatment of equals is discussed.[1]

b) Dependants: A specific exemption for dependants is established on the basis that each dependant requires a certain part of his supporter's income for his existence. A person with three dependants needs a satisfactory income larger than another who has just one child. Therefore, if both enjoy equal incomes, the latter's capacity to pay taxes is bigger than that of the former. To achieve equal distribution of the tax burden between these two persons each one has to be granted a special allowance regarding the upkeep of the children in proportion to their number. But a significant problem arises. It is possible that a child of three years old does not need the same amount of income for his existence compared to a dependant studying at a university. The latter needs a greater part of his supporter's income than the former, therefore, it is always considered that the difference in the age of dependants, the increase in age, should increase the allowance deductable from the taxable income.

Taking age differences into account will complicate the tax assessment and will increase the administrative work as it would be necessary, if these differences are considered to build up various scales which will depend mostly upon the consumption figures of individuals in various income groups according to their age. Another alternative solution is to take the average

1. It was proposed that "every income tax Act should have at least one scale of rate indicating the amount of tax due for certain age groups of income. The correct solutions, taking into account the composition of the family, can now be found by means of:-
   1. Various scales of family assessments...one scale for each size of family
   2. Separate scale rates, in addition to those for bachelors.
   3. The use of a general scale, the income of mot taxpayers being increased or decreased by a certain amount...before this scale is applied.
   4. A combination of 1,2 and 3, namely of several scales with several increases and/or decreases of the income. Ibid., p. 141.

consumption figure of a child from his birthday up to 21 years (the normal date of university graduation). This figure would be based on a somewhat arbitrary foundation, but I think that the age problem has to be solved arbitrarily in order to facilitate the administrative job of the revenue authority. Consequently, a clear rigid definition of dependants has to be provided in the tax legislation in order to eliminate tax avoidance, and tables of each type of dependants have to be drawn up in a way to avoid the misinterpretation of the dependancy status.

c) Earned versus unearned income:[1] Should a distinction be made between earned and unearned income with a view to achieving equity in distributing the tax burden? on the principle of ability to pay it is clear that the sacrifice of paying an income tax will be generally less on these incomes that result from the ownership of property without the labour of the taxpayer than in the case of those incomes derived almost entirely from such labour. The earned income is assumed to be more precarious or unstable than that unearned. Therefore, earned income has to be favoured regarding income taxation through granting special allowance for such income. A clear definition is required for terms 'earned' and 'unearned' income.[2]

Consequently, it is difficult to draw a demarcation line between earned and unearned income and the legislator has to depend on a semi-arbitrary way of differentiation.

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1. Earned income favourable tax treatment is discussed at length in Chapter 6.

2. In Britain, for example, the Select Committee on Income Tax of 1906 which discussed the British Income Tax, and especially earned and unearned income, stated that it is difficult to provide a completely logical and satisfactory definition, but it was found that a rough working distinction which would probably meet with general acceptance would be to regard the profits of private traders as earned and those of public companies and similar undertakings as arising from investment...the owner of the land who cultivates it himself would be regarded as earning his income..., but the owner of an estate who lets it to others to cultivate would not be regarded as earning the net income which he derived from the lands of that estate, although he might act as his own steward and devote much time to ite supervision. See. Report of the Select Committee on Income Tax, 1906, Cmd. (365) ix 659.

To sum up, horizontal equity does not require only the equal treatment of equals, but also it should consider some very important criterion in order to achieve its purpose. The criterion are:-

1) The nature of the income conception as distinct from capital and the differentiation between earned and unearned income.

2) The status for marital status allowances, including dependants.

3) Depreciation, depletion and other allowances from gross income to arrive at net taxable income.

4) The adoption of any averaging method applied to a specific period of time. It should not be left to the taxpayer's free will in choosing such period.

5) The valuation of inventory should be carried out in a uniform basis.

6) Losses to be carried out not more than one year backward and five years forward in order not to complicate the administrative structure.

7) Exemptions should be subject to an averaging method, thus, they should also be carried forward as most lower income taxpayers suffer a substantial loss of being below the exemption level for several years and suddenly they may enjoy large incomes afterwards. The solution, therefore, is to allow these taxpayers to carry forward the unused exemption from one year to another with a time limit.[1]

8) The incidence of the tax should be relatively determined in advance as it affects the real distribution of the tax burden. An analysis of the economic process which begins with the collection of variable taxes reveals that some taxes tend to remain with the persons paying them to the government, while other taxes tend to be transferred or shifted entirely or partially. In order to build up an equitable and productive tax system, precise studies are required to determine who ultimately pays the tax, since the fiscal payment of taxes may be quite contrary

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1. Due, op. cit., p. 181.

to the opinions of the majority of the public. Therefore, it is essential, before constructing a tax system, to study the shifting and the incidence of every particular tax included in the tax system separately, according to the economic and social conditions of the country.

Conclusion to the theoretical background of horizontal equity.

The foregoing analysis of the equity criterion has demonstrated that any interpretation of this criterion is almost absurd and also involves a great deal of arbitrariness. The various arguments which have encountered the equity question have proved inadequate for one reason or another. What we could say is that any choice or any selection in matters related to equity, is essentially, more or less, a matter of value judgement. These judgements are usually based on morale and political aspirations prevailing within a specific period, as the idea of equity changes continually and developes with cultural, economic and social conditions, and, therefore, it is relative and historical. As a matter of historical experience, the concrete meaning of this abstract concept has changed from age to age. Therefore, we cannot simply accept what earlier times have considered to be equitable but we must ask which system of taxation is compatible with our present idea of equity; or in other words, with our present political, economic and social environments.

Matters related to the theory of public finance in particular are largely nationalization of political attitudes.[1] Political value judgements should be based not only on pure political considerations but also on the economic and social impact of the tax system, on the structure and activity of the community as an integral unit. In many cases political considerations conflict with economic

1. P.A.M. Van Phillips, Public Finance and Less Developed Economy with special reference to Latin America, The Hague, 1957, pp. 120 - 121.

objectives or with social aims; therefore, the legislator, the economist and the politician has to reach a sound and practical compromise which would render the optimum benefit to the country as a whole.

In a less-developed economy revenue needs for economic growth usually conflicts with equity principle. The government for financing development programmes may increase tax rates, introduce new taxes, widen the tax base. This, most probably includes an increase in the fiscal burden of the poor strata which constitutes the major part of the population. Without impinging on low-income groups the Treasury would be nearly paralized in raising a sizeable amount of revenue. Within the framework of income taxation, in order to meet both social justice and government financial needs, income taxation should start from a reasonable minimum level below subsistence if a wider base of tax is required and it should be steeply progressive. Any scale of progression is closely linked up with government financial needs and stability rather than with equity principle.[1] Moreover, along with economic progress steeply progressive income taxes should limit the increase in the inequality in incomes. But on the other hand the rate of progression of the tax should be limited by its effect on the incentive to work, to save, invest and produce, as any increase in the scale of progression might have an adverse effect on the economy as a whole through the disincentive effect of the tax.

Consequently, it is inevitable in underdeveloped countries seeking to accelerate their economic development that their tax systems must suffer some departure from the strict basis of ability to pay, if the targets of economic development which form the imperatives of their national policies are to be attained at a reasonable period. Though the criterion of equity cannot suitably be applied to the tax system as a whole during the phase of development, this does not imply that it is not possible to correct specific elements of inequality in some parts

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1. Ibid. p. 121.

of the tax system.

By and large, equity is an illusive concept; it is also highly relative, particularly in judging any tax system. To form any judgement on the equity of a specific tax we should take into consideration not only the distribution of the burden of the tax under consideration alone, but we should judge the overall burden of the tax system as one unit. Again we may say that any judgement of the equity approach within the tax system is merely a value judgement closely related to the question of taxable capacity along with the question of the incidence of the various taxes comprising the tax system.

Finally, the burden that taxation imposes upon the economy is balanced, or should be, by the benefits that the economy derives from government services. But while it is possible to appraise with some degree of plausibility the tax burden at different income levels, it is much more difficult to estimate the value of the benefits that different income groups derive from government services. A comparison of the burden of taxation with the benefits derived is therefore a highly tentative and uncertain undertaking. Nevertheless, it is clear that a country with a democratic form of government such a comparison is somehow constantly being made by the voters. The economist therefore has little excuse for not attempting it in analytical terms.

The difficulty of comparing burdens and benefits lies in the fact that the services of the government are largely of an "overhead" character - notably administration, security and justice - and that the benefits flowing from them cannot be allocated convincingly to various income groups. Moreover the degree to which individuals with equal incomes avail themselves of particular services, such as highways, law courts, etc., varies widely. On the other hand, it has also been pointed out that the tax burden of similar individuals varies considerably according to whether or not, through smoking, drinking, or otherwise, they pay "avoidable" taxes. The lack of uniformity of incidence is therefore a problem that exists on both sides of the equation.

To attempt a comparison of tax burden and government benefits by no means implies the suggestion that the government ought to aim at equalising burden and benefits. It has sometimes been urged that taxation should be made equal to benefits, but in the thinking of economists, the "benefit theory" of taxation has long played only a subordinate role. Moreover, the practice reflecting the "benefit theory" employed by some governments, of earmarking certain revenues for the benefit of the payers of the specific tax (a petrol tax for highways), is generally regarded as undesirable because it breaks up the unity of the budget.

Consequently, no accurate method has yet been discovered to calculate the distribution of the actual benefits of public services among the population. This fact renders the problem of measuring the distribution of the tax burden more difficult. However, if any measurement were reached it would definitely include an element of arbitrariness.

<u>Horizontal Equity And The Egyptian Income Tax</u>:

Now, after discussing the question of the equal treatment of equals from the theoretical point of view and the problems related to the definition of the income concept, an attempt will be made to analyse the Egyptian income tax system from the horizontal equity viewpoint. Accordingly the analysis of this question will be basically concentrated on the definition of income as the tax base and the problems attached. The tax base has to be studied, in turn, from two separate points;

a) What is income subject to tax?

b) Who are the individuals and enterprises liable to the income tax?

The Egyptian Schedular income tax, like its origin the French system, does not include any straightforward definition of taxable income. But on the other hand a clear and simple classification was adopted by the Egyptian Schedular Tax, if one compares it with the British income tax. The classification of the Egyptian Scheduler income tax is based, primarily, on the differentiation of the various types of income according to <u>source</u>; i.e., income derived from capital, income from labour, and income from the combination of both sources. The Act ennumerates the taxable items as well as those exempt, while in a few cases it leaves the matter vague and to the interpretation of the Revenue Authorities and to Court decisions. Moreover, the legislation provides us with special cases which are subject to tax where it would otherwise not be considered as income and thus untaxable.

The Egyptian income tax Act followed the French interpretation of the term 'income' which considers income as the product of capital. In other words, income is defined as the periodical product or as a susceptible to periodicity of a durable source which consists of personal activity, work or other material wealth.[1] In order to keep the source of income intact a depreciation allowance should be deducted from gross income and accumulated over time to provide for the replacement of the exhausted source. This basic interpretation which is followed within the Egyptian legislation has some exceptions. To give a comprehensive

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1. This is what is called the theory of "utilisation" (these d'explotation). See E. Allix & M. Lecercle, <u>Impôts Sur le Revenue</u>; they stated (p. 351) "le revenue, avons-nous dit est le produit periodicque on susceptible de periodicite d'une source durable, qui peut consister dans l'activitie personnelle, ou travail, ou dans certains beins materiels ou incorporals".

analysis of the Egyptian income tax system from the viewpoint of its base, it seems desirable that the analysis should follow the same classification of the Income Tax Acts.

From the background of the Egyptian income tax system,[1] we find that the Schedular Taxes are levied on the different sources of income, taking into consideration the income concept in its narrow difinition, as its main object while paying little attention to the personal situation of the taxpayer. Per contra, the General Income Tax recognises the taxpayer's personal and civic conditions as an important factor in determining income subject to tax.

a) Income derived from negotiable property.

Under this schedule the term taxable income includes all types of dividends, interest and other profits derived from all sorts of shares and other securities, whether such profits are periodical or not and whether the distribution is affected or granted in the form of gratuitous shares or in any other form. Drawings on account of profits made by companies in favour of directors or members of the Board of Directors, or of any other party receiving a share in the profits and also a renummeration paid in whatever kind to the member of the Board of Directors, such as attendance fees, gratifications, or other emoluments of any kind. These provisions are not applicable to profits due either to managing directors or other directors, over and above the sums payable tothe other members of the Board of Directors, in return for administration work undertaken by them; Not more than two specially designated directors of any one company, however, may benefit from this exemption, provided that the total sums accruing to each director, either in the form of fixed renummeration, or as a percentage of the net profits or otherwise, should not exceed £E3,000 per annum. This also applies to redemption premiums paid to creditors and prizes drawn in lottery bonds paid to bondholders.

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1. See Appendix to Part 1.

Any type of the above mentioned income which is paid to an Egyptian or a foreigner resident or habitually residing in Egypt is subject to the tax, whether they are actual individuals or legal entities and whether such income is paid in Egypt or elsewhere. Therefore any Egyptian or foreign enterprise whose activities extend to countries other than Egypt, and even if their head or administrative offices are out of Egypt, are considered as carrying on a business solely in Egypt and thus any interest, dividends, or any sort of profit paid to any Egyptian individual or company residing in Egypt are subject to tax. Moreover, if any foreign company, any public authority or any other foreign service pays such income to an Egyptian or a foreigner residing in Egypt it is taxable.

Consequently, there are two basic rules which govern the liability of income under this Schedule;

i) The political allegiance, which comprehends the liability of all interest, dividends and the like paid to Egyptians living anywhere, and to foreigners residing or domiciled in Egypt, to the Egyptian tax.

ii) The economic allegiance indicates that any kind of income derived from any capital invested in negotiable securities in an Egyptian or foreign enterprise carrying business in Egypt is subject to the Egyptian tax.

b) <u>Incomes derived from interest on all privilege, mortgage, and ordinary debts and on all cash deposits and guarantees</u> due to Egyptians or foreigners resident or domiciled in Egypt, even if such interest is payable in respect of capital invested abroad, are taxable. Therefore interest accruing from all capital invested in Egypt is also liable to tax even if the persons entitled thereto are foreigners having no actual legal domicile in Egypt.

c) <u>Commercial and industrial profits</u>:

The Schedular tax levied a separate tax on profits derived from commerce and from industry, including profits derived from mining and other concessions or undertakings. Joint stock companies, Whatever the object of such companies, are liable to tax.

The Act has ennumerated other categories of taxable income while it would not otherwise be taxable according to the narrow interpretation of "income conception" within the framework of the theory of 'utilization' (these d'exploitation). Profits realised by persons, and companies acting as brokers for the purchase of buildings or businesses, or who habitually purchase buildings or businesses for their own account with a view to resale are subject to tax.

Profits made by stockbrokers, exchange brokers, agents working on commission, and in general every person, company, agency or office acting as brokers for the purchase and sale of all goods or valuables whatsoever, are also subject to income tax.

Other profits which could not/be easily identified as commercial or industrial profits, were also taxed according to the legislation otherwise, as above mentioned they become automatically exempted. Such profits are those realised by persons or companies who sell their land in lots after laying out roads and other works to prepare it for building or other establishment.[1]

Under this schedule although taxable income is defined according to the utilization theory other taxable elements are also taxable which is not considered according to this theory as income but the legislator ~~had to include~~

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1. Profits realised by persons or companies who give on lease commercial or industrial premises supplied with furniture or plant necessary for their use, whether or not the lease comprises all or part of the necessary installations for such business, are cubject to income tax under the provisions of Art. 32. Law No. 14 of 1939.

had to include it as taxable income as a precautionary measure against evasion if the individual tried to undertake large commercial operations within a prolonged time lag between each operation and, therefore, the periodicity of income could not easily be proved.[1]

Capital gains and losses are considered as ordinary gains and losses under two conditions; the first when a business sells an asset, e.g. a machine, for a price above the written value; the second case is when capital profits are realised by a broker, who undertakes stock-brokerage as a profession, from speculations in the stock exchange. Other types of speculative gains or losses are outside the scope of income taxes if realised by an ordinary person.

The folbwing are the most important and basic problems encountered in the enforcement of the Tax on Commercial and Industrial profits;

i) <u>The dilemma of taxing capital gains</u>:

Here the question of taxing capital gains, other than the above mentioned cases, arises. Is it possible to tax such gains even if they result from the changes in the price levels? Egypt has four exchange markets, two stock-exchange, one in Cairo and the other in Alexandria, and two markets dealing with Egyptian cotton at Alexandria, a future cotton market and a spot cotton market.

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1. Under the Tax on Commercial and Industrial Profits, the Act stated many peculiar items as taxable income regarded as commercial or industrial profits, but in fact they are of special type, 'suis generis', and, therefore, it was most practical to consider them as taxable income to alleviate the misinterpretation of the terms 'commercial and industrial profits'. The question of interpreting these terms is the most debatable question within the Egyptian income taxes. Thus to decide whether a certain profit is a commercial or industrial profit we have to refer to the provisions of the Civil Law and the Commercial Law as well, even though it would still be difficult to draw a sharp line between what could be considered as a commercial or industrial profit and between what could be notified as non-commercial profit. Accordingly, the legislators tried their best to interpret such debatable items in order to draw a line but they could not. Therefore, a state of conflict between the different laws was created and the Administration as well as the Legislative Authorities (courts) still suffer from such miscomprehension.

The dealings in the stock exchange markets are open to the public through a medium; i.e. the broker, while dealings in the cotton markets are relatively restricted to traders and exporters. This does not mean that individuals are not allowed to carry on transactions or speculations. The basic fact is Governmental restrictions are imposed on transactions in the cotton markets to secure the price of Egypt's major export crop. Minimum and maximum price levels are imposed for daily transactions. Other restrictions are imposed to eliminate the interference of outsiders in the cotton markets.[1] Briefly, profits or losses from the speculation in the cotton, at present, are of minor importance due to the limits and restrictions imposed on the daily price fluctuations. On the other hand, gains and losses realised from dealings in the stock-exchange are considered of some importance as it amounts sometimes to large amounts per person, as the transactions are almost free from any governmental interference (other than an overall supervision by the Government Representative at the Stock-Exchange).

As previously mentioned when discussing the theory of the taxation of capital profits in underdeveloped countries, especially those profits realised from speculation in the stock-exchange,[2] we believe that even the exemption of such profits from taxation may violate the equity principle, it is more beneficial to the country to exclude such profits from income taxation on the grounds of stimulating investment and increasing the rate of capital formation in the long run. Equity has, therefore, to be partially neglected for economic and also for administrative reasons in this case.

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1. Before the 1952 revolution, the cotton markets, especially the Futures market, were considered as the only place in the country where quick gains from speculation could be made. This resulted, in 1951 and early 1952, in huge capital gains realised by several persons who were considered outsiders. At 1951 and 1952 the price of the Egyptian cotton was almost double its price in the international market and the outcome was a decline in the cotton exports due to high prices.

2. See pp. 112-114

Yet gains from transactions in real property such as houses and land, have to be taxed when transferred through sale, exchange or bequeathed. Administrative problems might arise when enforcing this tax. At present, a proportionate fee is paid when the asset/is transferred and, therefore, it would be a relatively easy procedure for the Authorities to introduce the new proposed tax on that amount in excess of the selling price, i.e. capital gain. Severe penalties must be provided in case of fraud and false statements concerning the sale or the purchase price. Generally speaking, it seems relatively feasible and administratively convenient to levy a capital gains tax on profits from speculations in immovable property than on that realised from transations in the stock-exchange.

The rate of the proposed tax has to be fixed according to the socio-economic policy being adopted by the Government. A rate of 20% on such gains would sound reasonable if we compare it with the rate of the U.S.A. capital gains tax. Why not 10%, for instance? A relatively high rate, as 20%, in comparison to the proportionate rate of the Schedular Tax on Commercial and Industrial Profits, 17%, is desirable for economic reasons. This rate would help in eliminating the amount of investment in housing and land. Therefore, a shift towards more beneficial investment, e.g. industry, mining, etc., would have a high rate of economic return to the community which would help in raising the national income in a relatively higher rate. In general terms, this tax with its high rate could be rationally considered as a disincentive to invest in immovable property which is of minor importance to economic development.

ii) <u>The non-taxation of agricultural income and non-monetary income</u>.

The second important problem which renders the definition of taxable income equitable is the exclusion of agriculturel income from taxation unless it is realised by a joint stock company.

One of the most favoured sections in the Egyptian community is that which derives its income from agriculture. Agricultural profits are exempt from Schedular taxes. In 1950 an amendment took place trying to put things into order and to eliminate the inequity in the distribution of the income tax burden. It emphasised this exemption and brought the profits realised by the individual who rents a piece of cultivatable land and sublets to others into taxable income.[1] This amendment did not change much of the fact that agricultural profits are immune from income taxation. Besides, when the tax on aggregate personal income is applied, agricultural profits are calculated according to the rental value (minus 20% for maintenance and administration), which is already underestimated. Such favourable treatment which increases the inequality in the distribution of the tax burden was mainly due to the political power enjoyed by the landowners in Egypt.

Deriving from the above question is the problem of taxing the non-monetary income enjoyed by the agricultural population in the form of the comsumption of home produce.

Theoretically, non-monetary income should be included in the tax base in order to reach an equitable treatment of equals according to their relative taxable capacity. In actual income tax legislations, however, the tax base is ordinarily restricted, because of administrative considerations to income that is

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1. The difference between the rent paid to the owner and the rent collected by the first tenant from the second grade tenants is the taxable income. Art. 32 Law No. 14/1939, amended by Law No. 146/1950.

realised by the individual through exchange transactions, and hence this results in exempting from taxation the value of goods and services produced and consumed by the same household.

In most underdeveloped countries where the agricultural sector is of great importance, compared with other sectors of the economy, the proportion of home-consumed farm products amounts to about a half of the total agricultural income.[1] Moreover, there are other types of non-monetary income of widespread character in the agricultural sector such as the imputed value of owner-occupied dwellings, fuel gathered by the household and other types. Although these latter types of non-monetary income should be included in the tax base as it represents an increase in the taxable capacity of the individual, it is believed that to ignore the inclusion of such types would not violate seriously the equity principle as it represents a relatively small fraction of the aggregate income.[2] On the other hand the reasoning behind the exemption limit which is usually offered to income earners in the industrial sector could be met in the agricultural sector by exempting the non-monetary income which is, in nearly all cases, earned by individuals below the subsistence level. Therefore, the exemption of the non-monetary income in the agricultural sector is almost equivalent to the exemption limit offered, for example, to the wage earners within the industrial sector. Accordingly, such exemption does not infringe the equity approach.

Needless to say, we should notignore that part of agricultural

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1. The proportion of home-produced food in total food consumption in India, for example, is 63%, See, Report of the Taxation Enquiry Commission, 1953-54, Vol. 1. pp. 63-66. Government of India.

2. H.R. Wald, Taxation of Agricultural Land in Underdeveloped Economies, p. 113 Cambridge, Mass., 1959.

products which does not reach the market. Income from monetary transactions should be taxed according to the 'net income' criterion of taxation. Some difficulties might involve the taxation of cash income in the agricultural sector of the underdeveloped country because of the inefficient administrative apparatus and the widespread illiteracy among farmers.

Finally, the taxation of non-monetary income of the agricultural sector in underdeveloped countries is considered a very difficult if not remote from the administrative point of view. We need not worry about equity consideration in case of exempting such income as the majority of the farming polulation enjoy income below subsistence out of which the home consumed products compose a large proportion. The exemption in this case is more, or less, based on humanitarian motivations at the one hand and on administrative infeasibility on the other.

Egypt, as most underdeveloped countries, does basically enjoy an agricultural economy where the agricultural sector comprises about 35% of the national income.[1] Non-monetary income is represented to a large extent in home-consumed farming products.[2] It was estimated that out of the foodstuff grown in Egypt before World War II and early years of the War, " ¾ of it never reached the market, being retained for consumption by producers." [3] If we assume that the above estimation is still valid, if not (the percentage) being increased as the population increases by a rate higher than the increase in

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1. According to the Official Estimate of the National Income of Egypt for 1954, the agricultural sector amounted to £E310,153,000 out of the total figure of the national income of £E867,504,000. Statistical Pocket-Year-Book, 1955.
2. Agricultural population amounts to over 78% of aggregate population in Egypt; Op. cit.
3. J.I. Craig,"The General Rise of Prices in Egypt", L'Egypte Contemporaine, Cairo, 1941.

agricultural food products, we could deduce that in 1954,[1] for example, where the agricultural foodstuff produced amounted to about £E132 million (this figure includes basic foodstuff usually consumed by the average farmer, such as maize, wheat, rice, onions, and other products). Accordingly the amount homely consumed would amount to about £E100 million. The per capita consumption of home-produce within the agricultural population would be abound £E12 a year which is considered a very low figure (compare it with the exemption limit in the Schedular Tax which is £E100 a year for a single person).

Consequently, the exemption of the non-monetary income in the Egyptian agricultural sector does not represent any violation of equity. Moreover, any argument in favour of the inclusion of such income in income tax base could easily be defeated on humanitarian principles even if administrative difficulties could be surmounted.

(iii) Estimated versus actual income from a viewpoint of equity:

The Egyptian Schedular Income Tax, especially the Tax on Commercial and Industrial Profit, has always been a mystery to the administration for the various difficulties and problems it has faced, especially in dealing with the assessment of arrears. Several legislative measures have been taken to overcome such difficulties but it seems that such remedies are not enough to cure the illness. To make the above statement clearer we have to emphasise that according to the provisions embodied in the Law the tax should be assessed annually on the net profits of the business after a careful auditing of the taxpayer's accounts. Therefore, the basic principle in the tax assessment is that every year has its separate autonomous character from any other year. The only

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1. The year 1954 was chosen because the latest data available for national income estimates is confined to this year.

exception to that rule, as we will see later when discussing the question of exemptions,[1] is the carrying backward of business losses for three successive years.

As a result of administrative difficulties the capacity of the Taxation Department lagged behind the assessment of the accumulated returns. Therefore, legislative measures were sought in a trial to overcome such problems. Several laws were enacted fixing the profits of the year 1947 as a taxable base for the following years up to 1954.[2] The arbitrary and vigorous fixation of the tax base without taking into consideration fluctuations in profits due to changes in the economic or political environments, is a severe blow to equity doctrine which entails the equal treatment of equals according to their taxable capacity. On the economic basis the year 1947 was relatively a year of high level of profits compared to 1948 and 1949, while the level of profits increased in later years due to the Korean War; in 1950 up to 1952.[3] But in 1952 the rise in profits was mainly due to the sharp increase in cotton prices. On the other hand political instability of the later years, especially the year after the July Revolution, has affected the level of profits to a certain extent. These fluctuations in profits resulted in unequal distribution of the overall tax burden between taxpayers. Consequently several protests were lodged by the taxpayers. These provisions were abolished giving way to new legislative measures which are considered by the administration as more logical and equitable if compared

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1. Chapter 6 of this work, pp. 239-241.

2. Laws Nos. 240/1952, 587/1954 and 206/1955. These laws are applicable only in case of taxpayers who do not keep accurate accounts. Therefore, joint stock companies are not subject to these laws as they are obliged by the Comapnies Act to follow a sound book-keeping system and to publish its final accounts and the balance sheet every year.

3. <u>Budget Reports</u>, 1949/50, 1950/51, 1951/52. Egyptian Government, Ministry of Finance and Economy.

with the previous measures. However, the new act[1] has chosen the profits of the year 1955 as a base for assessing the tax for 1956, 1957 and 1958 profits if the base (1955 profits) is not over £E150; and only for 1956 and 1957 if the base year profits is over £E150 and does not exceed £E500. These provisions are only applicable to taxpayers who do not keep accounts. The tax authorities as well as the taxpayers have been given the choice of not being committed to the new measure if the actual profits (or losses) have been increased (or decreased); in other words the right to change the method of assessment depends on the choice of either the Taxation Department or the taxpayer according to the fluctualions which might have occurred in the taxpayer's profits.

This method of assessing the Tax on Commercial and Industrial Profits is advocated basically on administrative feasibility. On the other hand it could be attacked on equity grounds. Although the new provisions gave the right to charge the tax base of 1955 if a change in the taxpayer's profits occurred, it is a fact that this new provision would raise various administrative problems which would in turn affect the efficiency of legislation enforcement.[2]

It has been emphasised that, according to empirical data, over 60% of taxpayers subject to the Schedular Tax on Commercial and Industrial Profits earn an amount of profits below the exemption limit (£E100 for a single person, £E120 for a married person with no children, and £E150 for a married person with children) and that 30% of the taxpayers enjoy a profit of over the

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1. Law No. 102/1958 effective from 21/7/58.

2. From my experience as a Tax Inspector in the Taxation Department, I found that it is very difficult to discover any change in the taxable profits due to lack of information and to the poor existing machinery of assessment. Therefore, it is rather difficult to trace any increase in the taxpayers profits which might necessitate the change of the 'base'.

the exemption limit and not more than £E500 a year. Consequently only 10% of total taxpayers subject to the mentioned Schedular Tax will become unaffected by this new legislative measure.[1] This fact stimulated the authorities to bring into being the above measures to save wasted administrative efforts without severe violation to equity.

According to the above mentioned legislative measures, joint-stock companies, partnerships or any other form of company, are excluded from such measures, as these companies are supposed to keep regular accounts and follow a sound book-keeping system; besides they usually make profits of over £E500 a year. The importance of joint-stock companies in supplying a sizeable yield of the Tax on Commercial and Industrial Profits is quite obvious from the following data; these type of companies yielded over 56% of the aggregate yield of this specific tax in 1955/56.[2] The aggregate number of taxpayers under this schedule, including all types of companies, amounted to 397344 at the beginning of 1956 out of which 1334 are joint-stock companies. In other words, only 0.4% of the tatal number of taxpayers supplied a revenue of 56%

My conclusion to the foregoing analysis is that the new amendment seems to be beneficial and feasible from the administrative viewpoint, while it is clear breach of equity. The pracitcal judgement should be based on the experience gained from the performance of this legislative measure. As this measure is newly born any factual or basic judgement has to be postponed for the time being. I believe that to ensure an adequate enforcement of such measure

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1. Almost all taxpayers with profits under £E500 a year do not keep accounts and therefore it would be difficult to assess the tax which would in turn, be relatively small compared to the administration.

2. £E4,514,693 out of £E8,014,550. Statistics Div., Department of Taxation.

a special information division should be immediately established to enquire into the various cases where the taxable capacity of taxpayers represented in their respective profits have changed from that of 1955, the base year. This would curtail the element of arbitrariness in the tax assessment which, in turn, would decrease inequity embodied in this measure.

d) Income derived from wages, salaries, pensions and other emoluments:

The Schedular income tax subjects all types of emoluments of work other than that done by a self-employed person to a special Schedule. Income subject to this Schedule might be paid by either:-

a) A Public Authority, which includes the State, Municipal and Provincial Councils, or

b) Any Company, private individual or any other concern or organisation.

In the first case all wages, salaries and similar income paid to any person resident or domiciled in Egypt or elsewhere by any of the mentioned authorities is subject to tax. In the second case one has to discriminate between the following in order to determine the tax liability:-

i) If the Egyptian or the foreign enterprise pays a salary to a person resident abroad in respect of services performed abroad, such salary would not be liable to the Egyptian Schedular Tax.

ii) If the services are performed in Egypt, whether the employer is resident in Egypt or abroad, his renummeration is subject to tax. Ships flying the Egyptian flag, Egyptian Embassies and Consulates, and also Egyptian territorial waters are recognised as Egyptian territories. Thus any services performed by any individual, whatever nationality he is, are reckoned as services performed in Egypt.[1]

1. Law No. 14 of 1939, Art. 61.

iii) If a foreigner who obtains any type of renummeration is resident in Egypt, even if such emoluments are paid by a foreign enterprise and even paid in respect of services performed out of Egypt, such income is taxable.

The basic problem which usually faces the Administration is the interpretation of the term "resident" and "domicile". These terms will be elaborated when discussing the problem of double taxation.[1]

(c) Income from non-Commercial Professions:

Income derived from profits of liberal professions and other non-commercial professions practised in Egypt either by an Egyptian or a foreigner, is subject to the Schedule Tax.[2] Moreover, any income derived from any profession or activity not subject to any other Schedule is subject to tax levied on non-commercial professions.[3] This tax, for its widespread field of operations concerning its base; e.g. the diversity of persons[4] liable, is called the "general tax" of the Schedular Income Tax.

The liability of individuals to this tax is mostly confined to those exercising non-commercial professions independantly; i.e. self-employed, where labour is the main source of income.

The tax under this Schedule was firstly assessed on the rental value

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1. See Chapter VII, p. 279-280.

2. Liberal professions are those professions principally based on the personal activity of exercising an art or science, such as a physician, surgeon, accountant, scuptor and others.

3. The Law provided some exceptions which are exempted from this schedular tax, they are: a) All associations whose objects are not pecuniary gain, within the limit of their social, scientific and sporting activities, and also scholastic institutions. b) Any agricultural enterprise which is not constituted as a joint-stock company. (This is to affirm the exemption of agricultural profits of private enterprise and partnership.)

4. This is apart from the "General Income Tax" on total personal income by a separate Law. No. 99/1949.

of the place where the professional exercises his profession. (This provision was abolished later in 1950 and the tax was levied on the real income of the individual. This amendment took place after a prolonged criticism of the most favourable treatment to a special class of the community which was an obvious violation to the equity principle. There was a great relief to other taxpayers when the amendment came into force in 1951 and it seemed, however, that a fair balance in the distribution of the income tax burden is in sight. But such optimism did not last long as in December 1955 a peculiar Law (Law No. 642/1955) came into force offering special favourable fiscal treatment to professional self-employed university graduates.[1] They are given the choice of being assessed according to their actual profits or according to a fixed amount of money which increased according to the period of practice which starts from the elapse of the fifth year after graduation , (persons exercising a profession which necessitates a university or college degree are exempt from this tax during the first five years from the time of graduation).

On the other hand this new legislation excluded those who realised £E1,000 or more as net profits during the years from 1951-54, and, therefore, they are subject to tax on their <u>actual</u> net profits. Moreover, the new legislative measure provided another privilege to those who pay the tax on their net actual profits, that is the tax assessed on 1954 profits will be the same amount for the two successive years, 1955 and 1956, and so on.

These above mentioned special privileges given to a certain class of the community could be simply considered as a straightforward breach of equity. There is no apparent reason, administrative or socio-economic, for such privileges

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1. See appendix to Part 1.

and for the discrimination in fiscal treatment of the intellectual groups, self-employed, of the Egyptian community. The only reason which could be deduced from the events which were behind this Law is more or less political. The power enjoyed by self-employed professions through their respective unions put a pressure on the Government to revise the income tax on liberal-professions and to introduce the old way of tax assessment; that levied on the rental value of the place of practice. Consequently, I strongly oppose the application of this ammendment on equity grounds and I believe that an immediate abolition of such privileges is imminent in order to acquire fiscal justice. The tax should be levied according to the individual's taxable capacity measured by his net income.

f) The General Income Tax:

Following the Italian Income Tax structure, the Egyptian General Tax is levied on the total annual net income earned by the taxpayer and determined on the basis of income from real estate, movable property, professional earnings, indemnities, emoluments, commercial or industrial profits, pensions or annuities and other types. In general, all income subject to the Schedular Income Tax is also subject to this tax with some exceptions:

a) While some types of income realised abroad are exempt from the Schedular tax, they are subject to the G.I.T., e.g. commercial and industrial profits realised by an Egyptian carrying business abroad is exempt from the Schedular tax, while he is subject to the G.I.T. on the basis of "Political Allegiance".[1]

b) According to 'Buildings' Tax, the taxpayer's own house is subject to tax. But according to the provisions of the G.I.T., the assessment does not include the net imputed income of the house occupied by the taxpayer.

While the dominating outlook of the Schedular Income Tax is

1. While the Schedular tax on wages and salaries exempts any renumeration paid by a foreign authority to an Egyptian residing abroad, it is subject to the G.I.T.

is objective, it is different in the case of the G.I.T. It is the subjective outlook which dominates the latter and thus the individual taxpayer is the major factor in determining the liability to the tax. The following are the basic principles ruling the liability of individuals to the G.I.T:-

a) The political allegiance, as for all Egyptian nationals.

b) The principle of Domicile, as for foreigners domiciled in Egypt.

c) The economic allegiance, as for foreigners not domiciled in Egypt in respect of that part of their income which is realised in Egypt.[1]

The G.I.T. also exempts agricultural profits and therefore, it increases the fiscal favouritism to landowners who have long been immune from a real income taxation on their net agricultural profits.[2]

In general, the Egyptian tax structure and the tax returns are clear indication of how the system is based, partially, on a kind of political and socio-economic favouritism. A clear example is that the holders of State securities are completely immune from income taxation, present or future, with the result that every increase in the demand for public revenue has to be borne by other sections of the community; i.e. those who pay taxes through "the stoppage at source" mechanism (wage and salary earners and receivers of income from movable property). The imposition of the tax on general income does not seem to have improved such a situation; i.e. lessening the inequality in incomes and

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1. The Act provided two basic rules in considering the question of domicile of a foreigner: (a) if his principal place of residence is in Egypt; or (b) if his principal interests are in Egypt. The question of domicile, however, is still not solved by these two rules. As the Egyptian Laws could not inummerate all cases of foreigners domiciled in Egypt, he left the burden for the Courts to study each debatable case separately.

2. They only pay the Land Tax on the rental value which is estimated every ten years.

and wealth, even the later increase in the rate of progression which took place in August 1952, after the Revolution, and the sharpening of the sliding scale did not result in an effective change; as in 1958 the yield of the G.I.T. was about 20% of the total yield of income taxation.

Any successful application of the equity principle, which are objective and quantitive considerations, can be judged with reference to four factors:

a) The volume of national income and its distribution among individual and institutional taxpayers, and as between different sectors; e.g. rural and urban.

b) The aggregate tax load in the community.

c) The direction and extent of tax shifting.

d) The distribution of public services and commodities.

For the purpose of estimating the distribution of public benefits, the simplest but obviously least satisfactory assumption would be that all people share equally in the benefits of government services, irrespective of income or social status. The weakness of such an assumption is that many of the services that the Government renders aim at the protection, not only of the individual, but also of his income and wealth.[1]

The services rendered by maintaining order and providing protection may reasonably be regarded as being distributed in direct proportion to each man's wealth and income.

The benefits of social and cultural services provided by the Government seem to accrue, predominantly to the classes possessing power which obtain education and medical care in hospitals free of charge or below cost. But it would be wrong to assume that the members of higher income groups do not benefit from these services. If, for instance, the Government did not free

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1. See footnote on next page.

education, the higher income groups would no doubt resort to private education, but since the Government educational facilities are available to them, their own expenses for this purpose are reduced. Moreover, the upper classes also derive indirect benefits from the social and cultural services rendered to the lower income groups since an overall improvement of education and health raises the productivity of the economy as a whole.

The benefits of economic development, finally, are probably distributed among the members of the community in proportion to their 'stake' in the economic life of the country; i.e. in proportion to their income and wealth. This will certainly be true if develppmental expenditures raise total national income without changing its distribution, which is in fact the most plausible assumption in the absence of special policies designed to aid specific social groups.

Generally speaking, in Egypt as well as in most less-developed countries, data concerning the distribution of personal income, the distribution of the tax burden among various income groups and also the distribution of Governmental benefits are either not available to all, or, if part of the data is available, are incomplete and guesstimates. Besides, income tax incidence within the Egyptian fiscal system is very difficult to arrive at. This fact is not only applicable to the Egyptian tax but is also found in advanced countries

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Footnote 1 from previous page.
The value of this protection accorded to a person with a higher income or with more wealth is obviously larger than that rendered to a person with a lower income and little or no wealth. In order to arrive at a basis for a more adequate appraisal of the distribution of Government benefits, it appears, therefore, useful to distinguish between the following three types of benefits: 1. The maintenance of order and protection against internal and external disturbances; 2. Social and cultural services; and 3. economic benefits.

where any measurement of the shiftabiltiy and incidence of taxation is based more or less on arbitrary assumptions which could/be easily turned down if such assumptions are inapplicable in our real life.

Accordingly, it is regrettable that, for the above reasons, one is unable to measure the distribution of the income tax burden in Egypt in order to judge accurately the equity of t he t ax.

III. VERTICAL EQUITY STIMULATES PROGRESSION IN TAX RATES.

Taxation is commonly used, besides producing revenue, to reduce irregularities of income and wealth. This is mainly achieved by applying a progressive system of taxation which places a heavier rate of charge on large than small incomes, since the ability of the subject is assumed to increase in a more rapid ratio than the increase of his income. At the beginning of this century the idea of progressive taxation was elaborated on the ground that "the loss of a portion of wealth by a rich man is generally regarded as a very slight evil or as none at all, while to a poor one it causes cuttailment of real enjoyment."[1]

The changing of the centre of political gravity during the nineteenth century towards democracy has brought about the tendency to alter the distribution in favour of the most powerful class, which usually has a numerical majority. As the numerical majotity of the people were poor and from the middle classes the burden was heavier on the wealthy by means of progressive taxation. Moreover, progressive taxation tends mainly to exempt a limited amount of income or wealth from taxation as a necessity for the upkeep of the community. Basically

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1. C.F. Bastable, Public Finance, p. 305

speaking, the diffusion of socialist ideas assists the movement towards progressive taxation. The socialistic movement inclined most of the recent economists to favour the relieving of the poorer classes from the rigidity of excessive taxation. Therefore, a moderate progression was approved and highly advocated. At the same time income or wealth below a certain level was exempted from taxation,on welfare basis,of the poor class.

Progression can be found within a proportioned tax with the exemptions of the lower income group. This merely refers to the progression in the effective rate of the tax. Thus, proportional rate with a continuous exemption of the lower income bracket produces progression. This fact could be almost obtained without having progressive marginal rates. Such progression is apparent because taxpayers have a progressively larger fraction of their incomes liable to tax as they are just over the exemption limit. The effective tax rate will vary from zero at the exemption limit up to a point nearly reaching the flat rate of the tax, but it never reaches it.[1] From this statement, as the progression of the single rate

1. The following example illustrates clearly the progressice feature of a proportional tax with exemption limit. (A flat rate is 10% and exemption level £100 for all incomes.)

Income £	Tax Liability £	Effective % Rate	Income £	Tax Liability £	Effective Rate %
100	exempted	0	2,500	240	9.6
200	10	5	4,000	390	9.75
300	20	6.6	6,000	590	9.83
400	30	7.5	10,000	990	9.90
700	60	8.5	20,000	1,990	9.99
1,000	90	9.0	100,000	9,990	9.99
1,500	140	9.33			

according to the exemption of the lower income is inescapable we have to adjust the degree of progression through adding a certain amount of progression to the flat rate. This will mean graduating the marginal rates of the tax upwards, or in other words introducing a relatively steep progressive rate in the tax.[1]

If severe, progressive taxation could be viewed as a proportional one, the flat rate is applied to the top bracket and a series of exemptions graduated downward.[2] Therefore, the larger the income the smaller the exemption.

In order to achieve the basic aim of a progressive tax, i.e. eliminating inequalities in income and wealth, we have to find an answer to the following problem: how to construct the basis of progressivity? What will be the effect of the optimum degree of progression on the individual inequality of income and also on the size of the national income?

To formulate a scale of progression we must consider that the individual should not be deprived of the incentive to increase his income or his wealth through savings. Several economists tried to dsicover a formula for graduating taxation mathematically.[3] One of the folmulas proposed in early years of this century was that of Cassel's. This formula is based on the principle of equal sacrifices which leads to deduct from all incomes cartain necessities and to tax the remainder at a constant percentage. The necessities are not merely for physical subsistence, but also for perfect efficiency.

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1. From the point of exempting the subsistence income a system of graduated rates can always be approached and accepted as a graduated series of exemption. Thus exemptions, in particular, have defended and supported the general theory of progression.

2. W.Blum & H. Kalven Jr., Uneasy Case for Progressive Taxation, p.91.

3. G. Cassel, "The Theory of Progressive Taxation", Economic Journal, 1901, pp. 481-491

Therefore, "equal sacrifice means deduction of the necessities of efficiency and a proportional tax on the remainder."[1] The question of the average necessities for each class of taxpayers has to be considered on the basis that these necessities increase with income, but more slowly.

Statistics of the distribution of personal income should be available in order to be able to construct any scale of progression. Moreover, statistics of the various necessities of the different classes of the community have to be provided in order to determine the minimum and maximum of subsistence. But it is not easy to find a true standard for maximum subsistence as it is usually subject to various arguments which arise in deciding what elements should be included; besides it is difficult, especially in underdeveloped countries, to obtain accurate datea. The above mentioned method of scaling income taxation would become complicated in case of changes in the taxpayer's personal status, such as the increase in the number of dependants, deducting insurance premiums for a new contracted insurance policy, and different other variables. Therefore, new schedules have to be introduced quite frequently to consider the different abatements. One should emphasise that, however equitable a progression appears, any scale of graduation might involve a fraction of arbitrariness.

THE RATE STRUCTURE OF THE EGYPTIAN INCOME TAX:

The rate structure of the Egyptian income tax system varies and diversifies according to the structure of the system itself. Within the Schedular tax the rates differ according to the Schedule; i.e. according to the

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1. Cassel, op.cit., p. 485.

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type of income. As the Schedular income tax is of objective and impersonal character the rates are proportional with the exception of the Tax on Wages and Salaries which are progressive. On the other hand, the General Income Tax is progressive on aggregate personal incomes over £E1,000.

Personal exemptions in both Schedular and General Income taxes add a fraction of progression to the rate structure especially in lower income brackets. This fact could be easily observed from Table I which shows the effective and marginal rates of the Schedular tax, (see Figure III).

TABLE 17

Marginal and Effective Rates of the Egyptian Schedular Income Tax.[1]
(Married couple with children)

Income	Income from Movable Property			Comm.& Ind. Profits			Wages, Salaries, etc.		
	Liability	Effective rate	Marginal rate	Liab-ility	E. rate	M. rate	Liab-ility	E. rate	M. rate
		%	%		%	%		%	%
£E150	£E 25.5	17.	17	£E -	-	-	£E -	-	-
180	30.6	"	"	5.1	2.1	17	0.6	0.3	2
210	35.7	"	"	10.2	4.8	17	1.2	0.6	2
240	40.8	"	"	15.3	6.3	17	1.8	0.7	2
270	45.9	"	"	20.4	7.5	17	2.4	0.9	2
300	51.0	"	"	25.5	8.5	17	3.3	1.1	3
330	56.0	"	"	55.5	16.8	100	9.0	2.7	19
360	61.2	"	"	61.2	17	190	10.2	2.8	4
390	66.3	"	"	66.3	"	17	11.4	2.9	4
420	71.4	"	"	71.4	"	"	12.6	3.0	4
450	76.5	"	"	76.5	"	"	13.8	3.1	4
480	81.6	"	"	81.6	"	"	15.0	3.1	4
510	86.7	"	"	86.7	"	"	16.3	3.2	4.3
540	91.8	"	"	91.8	"	"	17.8	3.3	5
570	96.9	"	"	96.9	"	"	19.3	3.4	5
600	102.0	"	"	102.0	"	"	20.8	3.5	5
630	107.1	"	"	107.1	"	"	22.3	3.5	5
660	112.2	"	"	112.2	"	"	23.8	3.6	5
690	117.3	"	"	117.3	"	"	25.3	3.6	5
720	122.4	"	"	122.4	"	"	26.8	3.7	5
750	127.5	"	"	127.5	"	"	28.3	3.8	5

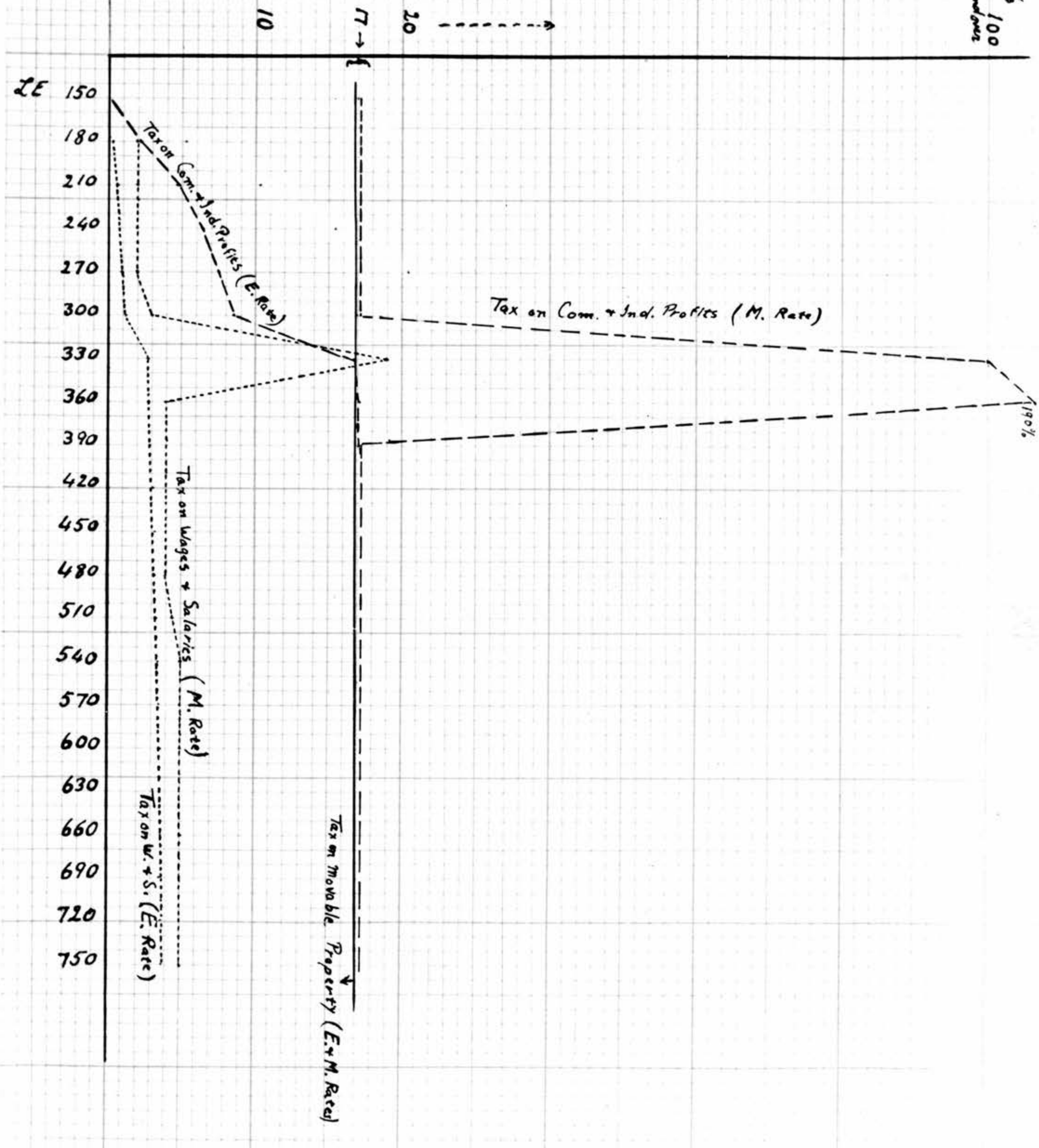
1. Tax Non-Commercial Professions is excluded for the diversity of its rates due to the new amendment introduced in December 1955. According to the amendment the taxpayers have the choice between paying tax on his net income at a rate of 11% according to a fixed amount depending on the period since graduation, (see appendix to Part I).

@. The rates applied in the Table are those in force at present. (Law No. 14/1939 Arts. 17 and 62.

FIGURE III.

Effective and Marginal Rates of the Shedular Taxes

(Married with Children)



Income from movable property (interest on securities, etc.) is always proportional and the effective rate equale the marginal one as there is no personal exemptions or any other reliefs to be deducted from taxable income and thus affect the tax liability. In the case of the tax on Commercial and Industrial Profits the effective rate (married person with children) varies from 2.1% just above the exemption limit to 17% on income over £E330; while the marginal rate, continues to be 17% up to £E300 and then jumps highly to 100% when the taxable income is £E330, then to 19% at £E360 and back to 17%. The steep increase in the marginal rate from 17% to 100% is mainly due to the withdrawal of the exemption limit when income reaches £E330. Actually the increase in the marginal rate starts when income starts to increase after £E300.[1]

In case of the tax on wages and salaries it is relatively different as the tax rates are progressive (the progression is of little importance as the rates vary from 2% on the first taxable £E120, to 9% on income over £E1,200; the rate increases gradually by only 1 %). The exemption limit; e.g. £E150, does also affect the rate of progression up to incomes of £E330 when the marginal rate increases sharply and reaches 19% and then drops to 4% on income over £E330 (e.g., £E360 in Table 17).

From the above data it is obvious, as in the case of the Tax on Commercial and Industrial Profits, and on Wages and Salaries, that the critical stage is when income exceed doubles the exemption limit; £E300 up till it reaches

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1. If the net annual profits exceed the limits of the personal exemption, e.g. £E150, but are not more than double these limits, the tax will only be payable on the surplus. If the net profits are more than double the limits of these exemptions, the taxpayer will not, by any exemption provided that his profits after payment of tax is not less than that remaining to the taxpayer whose profits are less than his. (Art. 41, Law No. 14/1939).

£E330. From the equity point of view those individuals whose incomes fall within the income bracket £E300 to £E330 suffer an excessive burden from the inadequacy of the rate structure. In case of the tax on wages and salaries the effect of such inadequacy is more severe than in case of the Tax on Commercial and Industrial Profits because in the former most of the middle salaried employees fall within the critical range, while in the latter the taxpayer can adjust his profits so that it would not exceed double the exemption limit, and if it did exceed such limit he had to adjust his prefits so as not to fall within the £E300 to £E330 bracket.

The general outlook of the rate structure of the Exemption Schedular Tax is almost proportional with minor exemptions due to the role played by the exemption limit.[1] To adjust the inequity resulting from the functioning of the exemption limit when it exceeds £E300 as in the above example, the tax rate has to be changed; increased or decreased, in order to avoid the sharp increase in the marginal rate. This problem couls also be solved by introducing a decreasing rate of exemption which attempts to smooth out the sharp increases in the marginal rate.

Now we turn to the General Income Tax with its progressive feature. This tax is levied on incomes over £E1,000 a year and allows £E50 a year for the wife and each child with a maximum of £E200; in other words the starting point of liability for a married couple with three children is £E1,200. From Table 18 and also from Figure IV we can observe that the scale of progression of the G.I.T is relatively equitable as the marginal rate structure does not include any sudden steep or sharp rises when income increases. One could say, in absolute terms, that the rate structure of the G.I.T. is more or less equitable if we compare it to the rate structure of the Schedular Tax.

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1. With the exception of the tax on movable property where there is no exemption limit.

FIGURE IV.

Effective and Marginal Rates of the General Income Tax

(Single Person)

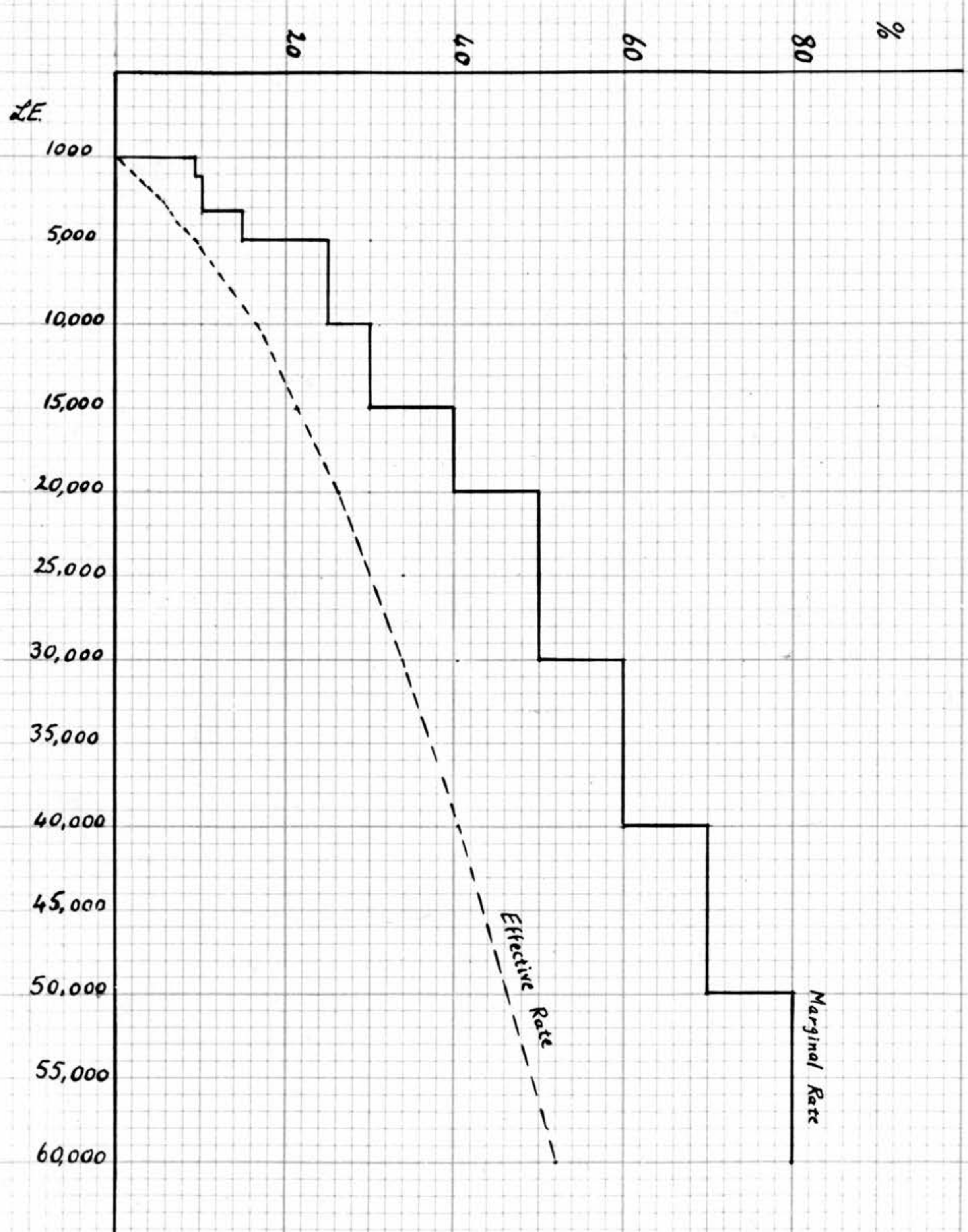

TABLE 18

Effective and Marginal Rates of the General Income Tax.
(Single person)

Income	Liability	Effective Rate %	Marginal Rate %	Income	Liability	Effective Rate %	Marginal Rate %
£E	£E -	-	-	£E20,000	£E 5,205	26	40
1,500	40	2.7	8	30,000	10,205	34	50
2,500	90	5.2	9	40,000	16,205	40.5	60
3,500	230	6.6	10	50,000	23,205	46.4	70
5,000	455	9.1	15	60,000	31,205	52	80
10,000	1,705	17.0	25	70,000	39,205	56	80
15,000	3,205	21.3	30	80,000	47,205	59	80

To evaluate the rate structure of both taxes, the Schedular Tax and the G.I.T. as one system, we find that while the G.I.T. introduces progression in the income taxation, the proportional rate of the Schedular Tax has more influence as most taxpayers who are subject to the G.I.T. enjoy incomes below £E5,000 yearly.[1] On the other hand the Schedular Tax rates differentiate between earned income and unearned income; it is a flat rate of 17% on earned income from negotiable securities and a progressive rate starting from 2% on the first £E120 taxable earned income from wages, salaries or the like and reaches 9% on income over £E1,200. The effect of the G.I.T. rate on such differentiation is quite clear as it reduced the difference in tax liability under the Schedular Tax

1. The aggregate number of G.I.T. taxpayers are 35,775, according to the latest available statistics (end of 1956) out of which about 85% enjoy a yearly income below £E5,000; Taxation Department, Statistics Division.

rate structure. If two individuals earn an equal income of £E2,000 a year, for example, the income of the first is from dividends and that of the second is from a salary. The Schedular Tax liability of the first will be £E340 and for the second person will be £E130. The G.I.T. is levied on net income after deducting the Schedular Tax liability, and therefore, the liability of the G.I.T. of the earned income will be greater; £E73.5 and £E54.5 of the unearned income.

According to the above example, one could emphasise that the G.I.T. has a redistributive effect on incomes subject to the Schedular Tax which did not exist before 1949. In other words the G.I.T. does not differentiate between earned and unearned income on the whole which, in turn, renders the G.I.T. rate structure as inequitable from that point of view. But this argument is obviously invalid as the G.I.T. is basically considered as a complementary tax on income similar to the surtax in Britain, for example. However, we should take into consideration the overall effect of both the Schedular Tax and the G.I.T. on earned and unearned incomes. The outcome would be that there still exists a difference in treatment diminished by the liability to the G.I.T. A reform is thus needed in order to introduce a differential treatment in favour of earned income subject to the G.I.T. The British experience would be of great help in this field.[1]

CONCLUSION:

The enquiry into the equity viewpoint of the Egyptian income taxes has shown various and diversified inequities which should be taken into consideration when attempting to reform the income tax system. Such inequities either in the

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1. The tax rates reform will be discussed when pointing out the major reforms needed for the development of the Egyptian Income taxation (Part III). See, the Finance Act, 1957 when the earned income relief was introduced into the British Surtax.

tax base or in the rate structure have to be valued carefully according to the socio-economic policy the country is planning. The policy maker has, in many cases, to choose between equity and revenue. His choice would be made according to the rate of economic and social growth the country is aiming for. But on the whole a compromise has to be reached between three major criterion; e.g. economic efficiency, equity of the tax system and lastly the need for revenue to finance economic development.

Chapter V.

The Economic Efficiency of the Income Tax.

To complete our investigation of the performance of the Egyptian income tax system we have to analyse and inquire into its economic competency. This chapter will be devoted mainly to the theoretical analysis and its application within the Egyptian economy of the effect of income taxation on a few major points of the utmost importance to the nation's economic welfare and development. The tax will be judged according to its impact on various aspects of the economy; such as; on the incentive to work, to save, and to invest.

Finally an analysis of the role of the Egyptian income tax as a stabilizer will be the concluding section in our investigation.

Income taxation may affect the functioning of the economy in two ways. In the first place, it may alter the supplies of the factors of production. Secondly, it may alter the decisions of business firms and thus the demand for these factors. By and large, both these effects will alter the level of the national income, its composition and its distribution. In other words with these effects on the national income the tax may have a considerable affect on the economic incentives which are of great importance to economic development.

In a less- developed economy like the Egyptian one, we believe that an analysis of the effects of the income tax on the basic economic concepts which are related directly to economic development should receive the lion's share of the analysis. Therefore, it seems adequate and fruitful to discuss the impact of the income tax on; (1) the incentive to work; (2) the incentive to save, and (3) the incentive to invest.

A. The Effects on the Incentive to Work:

Taxes on wages and on any type of remuneration from work were con-:sidered at the end of the 18th century and the beginning of the 19th century as a disincentive to work, and even more as a cause of reducing labour capacity through illness due to decreasing income. Such a way of thinking has been proved a complete fallacy and exaggeration.

The classical ideology about the effect of income taxation on the supply of labour is that it reduces the individual's ability to work, but on the other hand it might induce him to work more in order to make up for that part of his income absorbed by taxation. This is called the "income effect" of the tax.

An income tax affects the relative gain from work and leisure by reducing the rewards from work, and thus lessening the cost of leisure, in the sense of the gain from labour which is foregone because of the failure to work; this is usually known as the "substitution effect" or "Announce-:ment effect" in a relatively old-fashioned term.[1] The choice of the individual's scale of preference for income compared to leisure, differs

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1. Pigou used this latter term in his analysis of the economic effects of taxation. But latter economists such as E. Rolph, Musgrave, Phelps Brown and others, use the term "substitution effect" to indicate the same meaning. See, A. C. Pigou, A Study in Public Finance, London 1951, pp. 86-90. E. Rolph, The Theory of Fiscal Economics, Los Angeles, 1958; and also E. H. Phelps Brown, A Course in Applied Economics, London 1956, pp. 99-123.
The effects of an income tax upon the supply of labour have been debated for many years with little conclusive evidence developed. According to Richard Musgrave, a loss of leisure must be compensated by a gain in income (an assumption) - or vice versa - if the worker is to remain equally well off. In general, he argues that "both income and leisure carry positive utilities, and the surrender of either is a disutility". Cf. R. Musgrave, The Theory of Public Finance, New York, 1959, p. 233.

from one individual to the other and also depends on several homogeneous as well as exogenous factors.[1] Generally speaking, the reaction of the individual towards the tax depends on various factors:

(1) One of the most important factors is the shiftability of the tax. On the assumption that the taxpayer could shift his tax upwards or downwards, he would not be inclined to increase his working hours as his net income is not reduced; and therefore, he would not think of altering his leisure hours. If we assume that the shiftability of the tax is unlikely and that the demand on labour is constant, neither increasing nor decreasing, the labourers find it difficult to increase their income by that amount paid in taxes through working overtime. On the other side, the supply schedule of work might be inelastic and, therefore, any increase in the demand side would not be met by an increase in the supply schedule. This latter assumption might be true in the case of skilled labourers in under-developed countries while it is doubtful to be widely accepted in a highly industrialised country where technical training is a high level.

(2) The second important factor limiting the freedom of the individual to increase his working hours is the provisions included in the working contract and/or by the rules set up through trades unions. The influence of such provisions makes the worker unable to work overtime in order to increase his income by the amount of the tax paid.

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1. Reactions of workers to personal income taxes appear to differ under wartime and peacetime conditions. The patriotic motive may impel some workers to put forth their maximum effort to work longer hours, even though they are not completely satisfied with the marginal earnings after taxes. However, the experience of the war years should not be regarded as conclusive evidence for peacetime concerning the reactions of workers to taxation.

(3) The choice between work and leisure, or having a favourable 'income effect' on the incentives to work, depends on the mobility of labour between the various industries in the industrial sector, and also on the mobility of labour between the various sectors of the economy as a whole. The degree of labour mobility depends on different variable factors such as the demand on the various types of work, the degree of skill the worker enjoys, etc.

In a less-developed economy, unskilled labour is abundant especially in the agricultural sector, while skilled labour is relatively scarce. We also find that most of these countries suffer from the immobility of labour due to the lack of housing facilities, and the sentimental attachments they hold to their birth place. Moreover, trades unions are still in their developing stage and, therefore, their role in these economies is far behind that existing in Western countries for example.

(4) The rate structure of the tax has a considerable significance in our argument of tax effects on the incentive to work. A progressive tax involves a higher marginal rate than does a proportional tax; hence it involves a stronger substitution effect, adverse to work effort. In general, we might find that work effort will increase if the average rate of tax is raised, while the marginal rate is reduced or left unchanged.[1] Needless to emphasise, a proportional tax reduces work effort while a progressive tax of equal yield reduces work effort further; and when a proportional tax increases work effort, the increase is less under a progressive tax.[2]

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1. R. A. Musgrave, op. cit., pp. 242-43.
2. Ibid. p. 242.

(5) Another important factor which might alter the reaction of the individual towards increasing or reducing his work effort due to the tax effect is the consequence or the final impact of public expenditure. The benefits which an individual could derive from public expenditure are usually confined to two basic categories: (a) transfer payments such as pensions, family allowances, and the like; (b) public goods and services, such as education, health and other social services.

Transfer payments are frequently considered as negative taxes like any other subsidy. A proportional transfer payment has an income effect which is adverse to work effort and a substitution effect which is favourable to it. On the other hand, a proportional income tax has inverse effects of that of a transfer payment.

Under a progressive tax as well as under a progressive transfer payments, i.e. transfer payments with declining marginal transfer rates as income rises, the situation may differ. The marginal transfer rate may not only decline to zero but become negative. "Where the marginal transfer rate is negative and where leisure is not an inferior good, both substitution and income effects work towards reducing work effort."[1]

On the other hand, expenditure on services, such as education, health and other social services, increases the workers' productivity and thus increases his real wage. Therefore, the income effect in this case has an adverse effect on the incentive to work, while the substitution effect is favourable as the individual may be induced to increase his leisure

1. Ibid. p. 253.

time, However, no final behaviour could be easily established.

Generally, public expenditure, especially on transfer payments and social services, tends to decrease the disincentive effect of the tax on work. Income tax exemptions and reliefs have a similar effect as transfer payments if one compares a tax system which does not provide for personal reliefs with another which allows deductions for such reliefs. As exemptions reduce the effective rate of the tax and by implication the tax liability, the individual might not have the same incentive to work if there were no exemptions. However, personal exemptions do have an income effect which is adverse to work effort, especially within low and middle income groups who benefit considerably from such exemptions.[1]

Now, before concluding this theoretical analysis, we turn to the macro-analysis of this study.[2] It is very difficult if not impossible to establish a general criterion as individual behaviour differs from one person to another according to their utility indifference curves for both commodities, work and leisure. Two persons having the same income and bearing the same family and other responsibilities, may differ in their reaction towards the tax imposition.

If we divide the working population by income groups one might be able to reach certain conclusions. Business executives and professionals compose the high income groups of working population while ordinary labourers form the middle and low income groups. The first category

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1. This depends on the legislation in which income limits are stated for those who benefit from personal exemptions and reliefs.

2. For an excellent concise over-all analysis, see the article by R. Goode, "The Income Tax and the Supply of Labour", The Journal of Political Economy, 1949, pp. 428-42.

might be more positive in their reaction to the tax than those of the second category for the following reasons:
First, both marginal and average rates of the tax are substantially higher. Secondly, the range of choice between work and leisure may be much higher than in the case of wage earners. Thirdly, these people often have incomes from other sources that will increase their aggregate tax liability and thus they may be induced to increase their income from work if other sources of income tend to be difficult to increase. This argument could be dismissed as it is frequently believed that individuals with high incomes seem to have a neutral behaviour towards the tax imposed on their income from work. Rich people may suffer from the reduction in their disposable income through the decrease in their savings as they usually do keep the same level of consumption as before the imposi-:tion of the tax. On the other hand, if the tax reduces the disposable income of the middle and low-income groups to a lower level which would have a direct impact on consumption expenditure on necessities, their reaction would be in favour of the income effect and they accordingly may be induced to work harder to increase their income.

Unreservedly, we could clearly emphasise that the formal and theoretical arguments of the effects of income taxes on the effort to work is inconclusive. Empirical investigation could be of considerable help to us in reaching a reasonable conclusion in this matter. In Britain two empirical investigations were carried out in recent years to measure the effect of the income tax on the incentive to work.[1] Both studies showed that the income tax has no tangible effect on the individual's reaction towards the tax imposed on his income earned from work.

The Egyptian Case:

After setting out the theoretical background of the case we now look to its application within the Egyptian income tax. The Schedular Tax on Wages and Salaries, and also the Schedular Tax on Professions enjoy a relatively low rate. The first tax has a progressive rate varying from 2% on the first taxable £E120 to 9% on the income bracket over £E900 a year. The rate of the second tax is a flat rate of 11% or (depending on the type of profession and the taxpayer's choice)[2] a lump sum annual tax paid according to the period of practice.

For the sake of the analysis it is desirable to allocate the working population into three main categories: (i) agricultural workers; (ii) industrial workers, and (iii) professionals, including clerks and civil servants.

(i) Agricultural workers do compose the majority of the working force in Egypt; about 70% where the average wage per year is under the subsistence limit or what the tax provisions recognise as £E100 for a single person

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1. The first investigation was carried out for the Royal Commission on the taxation of Profits and Income, in which 1429 industrial workers earning less than £1,500 a year were interviewed about their reactions to income taxation. The general conclusive evidence of the investigation was that most workers thought that income tax was neither a deterrent to less work nor an incentive to increase work effort. See, Royal Commission on the Taxation of Profits and Income, Second Report, 1954 (Cmd.9105) p.92. G. F. Break undertook another investigation in 1956 which is different from the above mentioned one. The Royal Commission study was concerned with a different socio-economic group from that of Break who carried his investigation within a group of professionals in the London area. He concluded that the income tax has no disincentive effect on work. See article published by Break; "Income Taxes and Incentives to Work, an Empirical Study", American Economic Review, 1957, pp. 529-549.
2. See Appendix to PART I.

and £E150 for a married person with children.[1] In 1947 the average wage of the agricultural worker was estimated to be between £E12 to £E15 a year. At present it is believed to be higher due to the interference of the Government in fixing a minimum wage of 20 piasters (4 s.) a day. Agriculture is a seasonal occupation and thus the average working days are estimated as not exceeding 170 days a year.[2] This fact emphasises that the minimum annual wage - which is by all means not much below the average - is about £E34 for the adult worker.[3]

Generally speaking, agricultural labourers are almost, if not completely, non-taxable individuals under the Egyptian system of income taxation. Thus the tax effect on their work effort is non-existent.

(ii) The second important category is the industrial workers (including trade and various services such as those engaged in transport, public utilities, etc.). According to the latest industrial census of 1957 the number of persons working in the industrial sector of the economy

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1. The total labour force is estimated by about 10,600,000 in 1947 out of which 7,550,000 were engaged in agriculture and fishing. See, Statistical Pocket Year Book, 1957; and, U.N., Economic Development in the Middle East, 1945-1954, p. 27.

2. G. M. Said, Egyptian Economics, (Cairo, 1951 (in Arabic).

3. Egypt, as most less-developed countries, depends mainly on agricul:ture; children over 10 years to help their families by working either on their own land or by offering their work in limited seasonal periods, such as during the cotton picking season or during the season for collecting cotton worms (June to August). The average wage per day does not exceed 10 P.T. (about 2 s.)

amounted to 1,174,858 earning an average wage of £E2.38 a week (man wage): or about £E125 per annum.[1] Wages in some industries are above the average such as in petroleum extraction and refining; £E6.96 a week transportation, £E4.16 a week; and £E2.93 a week in metal industries.[2] This general survey shows that in many industries workers are above the exemption limit of the Schedular income tax and thus a considerable number of the industrial working force are taxable. For lack of detailed data concerning the number of workers in each wage group, one cannot estimate the number actually liable to tax.

Let us concentrate on the general division of labour in the industrial sector in order to reach a conclusion on the effect of income taxation on the effort to work, without putting much emphasis on statistical data which, unfortunately, is scarce. As in almost all industrial sectors of any economic institution, the working force could be easily, *a priori*, divided into three principal categories; (a) highly skilled labourers; (b) semi-skilled labourers; and (c) unskilled labourers.

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1. The reasons for the lowness of wages are due mainly to the low productivity of labour. This in turn is due to lack of training, malnutrition, and poor equipment in some industries. There is also the continual drift to towns from the disguised rural working force, resulting in a large reserve of unemployed unskilled labourers who "depress wages; for low as they are, real wages in towns are higher than the countryside". Cf. C. P. Issawi, *Egypt at Mid-Century*, London, 1954, p. 171. For the above data, see, *Statistical Pocket Year Book, 1957*, U.A.R., and also, "Statistical Supplement", *International Labour Review*, December 1958, p. 199.

2. Statistical Pocket Year-Book, op. cit.

In Egypt workers of the first and second category are relatively limited in number if compared with the third category where the supply of unskilled workers is considered highly inelastic due to their abundancy and the persistent high level of unemployment. In most cases unskilled labourers earn an average wage less than the exemption limit and, therefore, they are not subject to income taxation. In this regard they could be qualified in the same way as the agricultural labourers.

On the other hand, skilled labourers in a developing country like Egypt are relatively scarce and hence their supply is elastic. Accordingly, their wages are comparatively high and usually are above the exemption limit.[1] For lack of empirical investigation concerning the reaction of this category of workers to the income tax, one could not reach any conclusive statement; but on the other hand we can hazard the opinion that the average worker in Egypt is both unaware of the amount deducted from his wage in taxes due to the high level of illiteracy, and pays a small amount of tax so that again the effect of the tax on incentives is likely to be small.[2]

Collective bargaining through trades unions has not yet fully developed as is the case in highly industrialised countries such as the United Kingdom or the United States of America. This might be attributed

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1. This fact could be easily observed from the Industrial Census of 1957. The average wage in highly skilled industries such as mining, shipbuilding (repairs), electricity, etc., is above £E150 a year. See, Statistical Pocket Year-Book, op. cit.

2. See Appendix to PART I.

mainly to political reasons. Up till recently, employers used to hold strong influence within the Government administration. Such a state of affairs created a strong bargaining position for the employers, owing to existing monopolies which the trade unions were unable to meet or compromise with.[1] After the 1952 Revolution trade unions' bargaining power increased due to their surmounting political position in the construction of the present politico-economic set-up. Favourable labour laws were issued in an attempt to organise trade unions and also to establish a boundary to protect the working force against the maltreatment of the employers. Working hours have been steadily reduced mainly as a result of the increasing influence of trade unions. This does not indicate that the collective bargaining machinery in Egypt is fully developed if compared to the British one for example, but our emphasis is related to the situation that existed in the country in the post-war period up to the early 1950's.

Increase in wages which has been the major characteristic of the Egyptian industrial sector since the outbreak of the Second World War was due basically to the increasing cost of living. No one could prophesy that the reduction of the carry-home wage due to the tax did not stimulate the unions to shift the tax backwards to the employers through increases in wages; but, as previously mentioned, income taxation has never been a source of major complaint for wage increase. Finally, it could be said that the Schedular Income Tax on wages has neither a positive nor negative effect on the incentive to work within the labour force of the industrial sector of the economy.

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1. C. P. Issawi, op. cit., pp. 171-72.

(iii) Professionals and/or self-employed individuals in Egypt who are liable to the Schedular Tax on non-commercial professions amount to about 23,000 according to the latest available data.[1] This class of taxpayers has always been favoured regarding their liability to the Schedular income tax. Up till 1950 they used to pay the tax according to the rental value of their place of practice which resulted in the decrease of the tax burden to the minimum. From 1950 to 1955 they became assessable on their real net income at a flat rate, a relatively low one, of 11%. Such new treatment aroused their unjustifiable anger and for political reasons, more or less, the Government in 1955 issued new legislation granting considerable inequitable privileges only for university and college graduates.[2] On the whole, it is presumed that the low tax rate on the one hand and the obvious fiscal privilege enjoyed by a large proportion of this class of taxpayers, did minimize the adverse effect of the tax on the incentive to work.[3]

In concluding our analysis on the effect of the tax on the incentive

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1. According to latest available date of 1957, Department of Taxation, Cairo.

2. This point has already been elaborated from the equity viewpoint in Chapter 4.

3. Taxation of the self-employed depends largely on voluntary compliance. In contrast, most wages and salaries are subject to withholdings. It is commonly believed that independent professional practitioners (and also small businessmen) have been less fully taxed than others. In spite of the low tax rate applied, and to the high standard of education, this category of taxpayers enjoys, there still exists a considerable percentage of evasion within this class.

to work, there is a counteracting factor which remains to be considered, i.e. the effect of the free availability of Government services upon the incentive to work. While most Government services cannot be substituted for privately purchased goods and services, some of them can, as in the cases of medical care and education. To the extent that the taxpayer is able to get these things free from the Government, the pressure to work is reduced.

From the foregoing discussion, we can assess that there are conflict-:ing forces affecting the incentive to work. Whether the net result of these conflicting forces is an increase or a reduction in work effort depends, of course, upon their respective magnitude. In Egypt, the progressiveness of income taxation, especially the Schedular Income Tax becomes very lenient, the curtailment in marginal income brought about by taxation ought not to be unduly discouraging to work effort. The total income tax burden likewise is not heavy, but in so far as it has any influence, it tends to increase effort. The counteracting effect of free Government services should be of a small order, considering the volume and nature of these services.[1] On the whole, it may, therefore, be concluded that the Egyptian income tax minimizes the adverse impact of taxation upon the incentive to work.

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1. Total Government expenditure on education, health and social services was estimated to be about £E51 millions for the fiscal year 1958/59 (this figure includes wages and salaries and other expenditure on the administrative machinery.) See <u>Budget Report</u>, 1958/59, Southern Region, United Arab Republic.

B. <u>The Effects on the Incentive to Save:</u>

A person saves if he spends on consumption less than his income in a given period. Each individual is restricted in the amount he saves by his income; and the size of his income is determined by other people's expen:diture on the goods he produces. Each individual considers his own income as given and independent of his own expenditure, and, not being interested in the effect of his expenditure in creating income for someone else, he sees no connection between income and expenditure. Generally speaking, savings are dependent on consumption and on income simultaneously. Hence:forth, savings could be defined as the total amount withheld from con:sumption during a given period.

Savings take one of two shapes; either forced (involuntary), or free (voluntary). The former type arises when a person produces something that cannot be consumed, or when compelled by legal or conventional action to set aside part of his income and not to use it for immediate expenditure on con:sumption; e.g. contribution to old age pension schemes, social security system, etc. On the other hand, voluntary savings are only conducted by the will of the individual and his choice of deferring the spending of part of his income for certain motives. Therefore, the last type, the voluntary saving, is the type we will take into consideration when analysing the effect of income taxation on the incentive to save.

An income tax reduces the disposable income inclined to be spent on consumer goods and on capital goods through savings. Therefore, income taxation has a direct effect on the consumption function and on the propensity to save.[1] The effect of the income tax depends primarily on the pattern upon

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1. J.F. Due, <u>Government Finance</u>, p. 214 and 362.

which the individual allocates his income after tax between consumption and saving. The effect on either consumption or savings depends on various factors which motivate the behaviour of the individual taxpayer. These factors could be summarised in the following:

(1) The amount of income and its position in the income structure as a whole. It is emphasised that individuals in low-income groups are mostly affected by the imposition of the tax which reduces or eliminates their ability to save, as they would not be able to reduce their consumption by the amount of the tax paid if such expenditure on consumption gives them the bare necessities of an acceptable standard of living which could be within the subsistence level. As the average individual will not approve of a reduction in his standard of living beyond the subsistence level in order to save; or if he prefers an immediate enjoyment rather than future benefit, he will try not to reduce his expenditure on consumption and reduce or eliminate completely his savings.

An individual in a well-to-do class, i.e. the middle and above the middle classes, is considered to be in a relatively different situation concerning his personal behaviour towards the tax. If such a person is thrifty and tries to keep his savings rate at a certain level in spite of the tax effect, he will reduce his consumption expenditure. This might not be the case of another individual in the same income group, as thriftiness is a characteristic phenomenon not widely experienced. Persons, however, differ in their behaviour towards allocating their disposable income between consumption and saving, and, therefore, a general sound rule is difficult to draw.

The effect of income taxation on the propensity to save of individuals within the high income groups is that it reduces their savings by nearly the amount of the tax, as most individuals within this income group try not to alter their consumption expenditure in order to keep up their standard of living and thus they have to reduce their savings. The impact of progressive taxation is more severe on individuals within high income brackets and, therefore, their decision to save is dependent on the aggregate future income derived from savings and other sources subject to high marginal rates. Their behaviour towards altering their savings or their expenditure on consumer goods depends on the marginal utility of the last unit to be spent on consumption compared to that saved which automatically will be subject to tax on the future fruits.

(2) The civil status of the individual has a great influence on the incentive to save. A bachelor with the same income as that of a married man with two children will suffer less from an income tax which provides no allowances or personal reliefs. The ability of the bachelor to save part of his income will not be relatively affected by the tax if compared with that of a married man.

(3) Public services and transfer payments affect the incentive to save as they reduce the tax burden on the taxpayer. The reduction in the tax burden due to such services and payments varies according to the type and value of benefits acquired by the individual; as some individuals do not make use of such services and, therefore, their real tax burden is not affected.

Consequently, it is difficult to set up a general rule on the level of a macro-analysis as the behaviour of various individuals towards public services differs; but on the other hand, one could assess that these services do reduce the real tax burden of both lower and middle classes at least and hence increase their ability to save if it did exist.

The Egyptian Case:

The propensity to consume in less-developed countries is very high compared to highly developed countries, and hence the propensity to save is considerably low.

Productive savings in less-developed countries are low due to various and diversified factors. Among those factors are, the predominance of agriculture organised on small-scale farming, small industrial undertakings, integration of business savings with personal savings, and hoarding. The "demonstration effect", in Duesenberry's words, reduces the level of savings considerably especially within the rich class of the population from where savings usually originate.[1] The importance of conspicuous consumption, growing awareness of the advanced standards of living shifts the consumption function upwards, thereby reducing voluntary personal savings, hampers the use of domestic potential sources of capital and, furthermore, creates balance of payments difficulties due to the fact that industrialisation leads to increased imports, first in the form of machinery, equipment and other capital goods and secondly in the form of consumption goods.

The Egyptian personal income could be divided into three income groups;[2] (a) High income group consisting of individuals who enjoy an income above £E1,000 a year;[3] (3) this class is very limited in number, about 0.18% of

1. J.S. Duesenberry, Income, Saving and the Theory of Consumer Behaviour, Cambridge, U.S., 1949, Chapter 2.

2. No official data is available regarding the distribution of the personal income among the various income groups. My present classification is a rough and general outline devised to serve only as a guide for the analysis.

3. Those who enjoy income of £E1,000 or over are subject to the General Income Tax, their total number is 42,005 (latest survey carried out by the Taxation Department in 1957).

the country's total population. This class of individual consists of part of the landlords,[1] businessmen and a considerable part of the self-employed professionals. (b) The second class which could be called the middle class is also limited in number and includes the individuals who enjoy an income below £E1,000 and above the exemption limit provided by the Schedular income tax. This class consists mostly of civil servants, small landlords, a limited number of the labour force within the business sector, tradesmen, artisans and the rest of the self-employed professionals. (c) The third income group includes all individuals at the subsistence level (the exemption limit) or below. The majority of the population especially the working force in the agricultural sectors falls in this category.

High income groups, or what we could denote as the rich class, in underdeveloped countries do react towards the reduction incurred in their incomes as a result of the income tax by either reducing their savings to keep up living standards at the accustomed level in order to restore their prestige in the community, as they cannot reduce their conspicuous con-:sumption. On the other hand, some individuals within this class may reduce their consumption in order to stabilize their rate of savings. This latter case is of a limited character in underdeveloped countries as most rich people try to keep their conspicuous consumption at the same standard, i.e. before the tax imposition, as far as their real wealth is not diminished. Therefore, it is most probable that in a country like Egypt, where the rich class is limited in number and where the expenditure

1. Only landlords who own over 50 feddans could be included in this income group as the average rental value per feddan could be estimated at £E21 per year (the rental value is fixed by the Land Reform Law of 1952).

on conspicuous consumption predominates, it is believed that the income tax, especially the General Income Tax with its high marginal rates, does have a disincentive effect on the rate of saving.

The second class in our analysis is the middle class which is also limited in number. The effective rate as well as the marginal rate of the Schedular Income Tax are relatively equal, they do not exceed 17% in most cases with the exception of individuals earning a few pounds over double the exemption limit.[1] We could simply emphasise that the majority of taxpayers who come under this class, as previously mentioned, are employees and wage earners where the marginal rate as well as the effective rate does not exceed 5%. This relatively low rate might have little, if no effect at all on their propensity to save. This fact might be true - taking into consideration the lack of empirical investigations, if we bear in mind that thriftiness is an obvious characteristic of the middle class and, therefore, any reduction in their disposable income due to income taxation would, most probably, be reflected on their consumption, i.e. decreasing it, more than it would affect their amount of savings. The actual rate of savings before or after the tax, is mostly dependable on whether the taxpayer is saving for old age if self-employed, or that his employer, if he is a wage earner, contributes towards a pension scheme or any other social security fund. In the first case the taxpayer would not reduce his amount of savings as old age security does have a considerable significance to the individual, to which in the second case the contribution of the employer accompanied by a forced deduction from the employee's wage is considered a safeguard to the taxpayer, and,

1. See Chapter 4, p. 152 , and Figure III.

therefore he would not put much emphasis on reducing his consumption in order to stabilize his amount of savings, or in other words, he would reduce his savings by the amount of the tax. In practice, income tax legislators do allow the deduction of subscription towards old age pension schemes from the tax base and, therefore, the tax tends to have a minor effect in this connection.

By and large, we find ourselves inclined to believe that the Schedular Income Tax does not have a tangible effect on the incentive to save among taxpayers within the middle class.

Now, we are left with the poor class, those earning income under the subsistence level. On the whole, the tax has no effect on this class as the poor have a negative propensity to save, besides they are completely exempt from the tax.

C. The Effects on the Incentive to Invest.

Investment decisions are basically influenced by the net return of capital invested. An income tax, unless reflected in reduced consumption, goes to curtail the taxpayer's net worth and would change the initial distribution of such net worth and also the terms at which funds are available to the borrower.[1] Any investment decision does involve the risks or the probability of a loss. It will not be taken unless the expected return appears sufficiently remunerative. "In every investment decision the investor weighs the advantage of a greater return or yield, against the disadvantage of a possible loss or risk".[2]

An income tax, proportional or progressive, reduces the net yield of

1. R.A. Musgrave, The Theory of Public Finance, p. 333.

2. E.D. Domar and R.A. Musgrave, "Proportional Income Taxation and Risk Taking", Quarterly Journal of Economics, Vol. LVIII, 1943/44, p. 388.

investment and thus reduces the amount of risk-taking. Risks in invest:ment, predictable or unpredictable, control individual behaviour in choosing the most suitable type of investment. While predictable risks are of minor effect on the incentive to invest as it is comparatively easy to forecast such risks, the unpredictable risks or uncertainty is difficult to assess in advance and thus their influence on investment will be great. Investment in risky ventures demands a relatively high return compared to investment in secure types, such as government bonds. On the other hand potential investors differ in their asset preference, owing to differences in tastes, needs, or restrictions imposed by the nature of their balance sheets. Some investors want to hold cash, others prefer secure investment, e.g. in land and buildings, government bonds, and still others seek larger returns at greater risk. As a consequence of the various and non-uniform individualistic behaviour, the supply of funds to various types of investment outlets differs, depending on whose savings are reduced by the tax. On the other hand, the demand for funds, progressive taxes reduce funds available by the well-to-do class of the community.[1]

By introducing an income tax, or increasing the rate of the already imposed tax on the net return of business will alter the course of events concerning investment decisions. Each investor will form an estimate of the business's chances of gain, different from what he would have done had there been no new tax or no increase in the tax rate. The uncertainty schedule will, therefore, be different than the first, i.e. what it would

1. Progressive taxation may differ considerably "in their qualitative impact on investment (per dollar of reduction in available funds) from proportional or regressive taxes which reduces funds supplied by the small investor". Cf. R.A. Musgrave, op. cit., p. 333.

have been had there been no additional tax. The change of uncertainty schedule will be influenced by the change in the net return after the imposition. The marginal investor in risky business will be inclined to direct his investment towardssafer kinds.

Another important factor in formulating any investment decision is "opportunity cost", i.e. the income sacrificed by not investing in alter-:native lines. It is apparent that a shift to the left of the opportunity curve will have different effects according to whether the investor's pessimism about risky ventures has increased, i.e. he believes that for any given risk the expected yield is smaller, or whether the left shift is due to the imposition of the tax.[1] The outcome of the tax imposition is that alternative earning possibilities are reduced too, and this would weaken the substitution effect and strengthen the income effect.[2] The opportunity cost of safer alternatives, which is zero before and after the tax, e.g. consumption or hoarding, is shifted to the right due to the tax imposition.

Generally, investment decisions in risky ventures which are affected by the tax imposition are susceptible to various factors which reduce the tax disincentive effect. Such factors are; (a) granting an accelerated depreciation for capital assets; (b) loss-effect against profits by carrying it forward or backward; (c) direct government expenditure through subsidies to risky business; (d) increasing public expenditure on social overhead capital; (e) partial or full exemption from direct and/or indirect taxes; and various other inducements undertaken through the public authorities which will reduce the amount of risk taken by the

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1. Paul Streeten, "The Effects of Taxation on Risk-Taking", Oxford Economic Papers, Vol. 5, 1953, pp. 285-286.

2. Ibid.

potential investors.[1]

Uncertainty involves a possibility of loss, but where there is a danger of losses there is also a hope for capital gains. The taxation of capital gains does have an effect on investment decisions. If such gains are untaxed or taxed at a low rate the investor's reaction towards risk-taking is lessened relatively to the case where capital gains are taxed on the same level as ordinary income. Returns of this risky investment, according to this argument, can be taken in the form of capital gains instead of taking them in the shape of dividends which are subject to higher tax rates.

Now we come to the effect of income taxation on capital formation within an underdeveloped economy. Taxation, especially on income, does have a direct impact on capital formation in highly developed countries as well as in a less-developed one. But in the former countries the effect of income taxation is considered greater due to the high marginal rates imposed on high incomes out of which most business and personal savings is generated. In underdeveloped countries where the average income per capita is below the subsistence level, income taxation does have a relatively inferior impact on capital accumulation. This assessment has to be evaluated carefully when considering the role of income taxation in capital formation as any fiscal policy for investment should, therefore, consist largely in minimizing the interference of taxation with the incentives to absorb private savings in productive investment. In general, income taxation in a developing economy should have an incentive effect more than having a neutral impact on capital formation in order to stimulate savings and

1. Most of the above inducements for investment will be discussed in Chapter 6 of this work when discussing the question of Income Tax Exemptions in detail.

hoardings to be invested in productive channels.

However, one of the main problems of capital formation in under-developed economies is incentives, fiscal or others, which has to be created to stimu-:late private investment, both domestic and foreign. On the other hand, most underdeveloped countries could increase the proportion of their national income taken by taxation without unduly disturbing the economy.[1] Such proportion will differ from one country to the other depending on the citizens' behaviour and tastes; on the administrative competence of the government machinery; on the relative importance of tax rates, and the standards of external economies as barriers to private investment.[2]

Fiscal policy, in general terms, has to be directed towards the creation of the most favourable climate for capital formation and the chanelling of capital into the most productive investment. Tax incentives (have been mentioned above)[3] are; exemptions from income taxes for a limited period, losses offset, the promotion of social overhead, etc. On the other hand economists generally agree that additional taxation should take care of income that would otherwise have been spent on luxurious consumption and unproductive investments, viz: foreign exchange, gold, land properties, and other stock of inventories.[4]

A final word in this context has to be mentioned, that is the compara-:tive importance of the rate of interest within a less-developed economy on

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1. E.M. Bernstein and I.G. Patel, "Inflation in Relation to Economic Develop-:ment", International Monetary Fund, Staff Papers, Vol. II, November 1952, p. 395.

2. U.N., Taxes and Fiscal Policy in Under-Developed Countries, New York, 1954, p. 7.

3. Cf. P.A.M. Van Philips, Public Finance and Less-Developed Economy with Special Reference to Latin America, The Hague, p. 122.

4. See page

the one hand and the income tax on the other. Lack of capital and underdeveloped banking institutions and in less-developed countries result in the prevalence of high rates of interest which sometimes exceed double that found in highly developed countries.[1] Now, what is the position of an income tax of a relatively low rate to the would-be investor? High rate of interest has no doubt a great active effect on the investor's decision while the tax on his profits is of a relatively minor importance. A profits tax is usually levied after the realization of net profits - after the deduction of interest rate on capital borrowed, as well as other expenses incurred in realising such profits. If the investor realizes a net loss he will not be taxable while he has to pay the high rate of interest on his borrowed capital. In general, one could say, with some caution, that income taxation in underdeveloped countries with its moderate rate structure, does have a relatively minor effect as a disincentive to invest especially regarding domestic capital.

The Egyptian Case:

Private as well as public investment in Egypt has been recently subject to various studies by the National Planning Commission. It has received great attention after the 1952 Revolution in an attempt to use private and public resources, foreign and domestic, to raise the standard of living. Fiscal policy measures, especially taxation, were considered from its effect on stimulating private investment. The first action taken by the Government was the issuing of a new Law providing for income tax exemptions for new

1. The absence of institutional investors and the rudimentary form of the capital market cause potential investors to be more dependent on bank credits. Generally, in less-developed economies where the ratio of liquidity preference is high accompanied by a low propensity to save along with a low and capital-output ratio, the result is significant within the monetary system. A high rate of interest is, therefore, of predominant character especially for medium and long-term loans. See, Van Philips, op. cit., p. 67.

enterprises undertaking new investment in specific fields considered of relative significance to the economic development.[1] The second step was taken later in 1954 by issuing a Law which opened the door to foreign capital to be invested in Egypt through concluding double or multiple tax conventions. Several other fiscal as well as other economic measures were taken towards the stimulation of investment.[2] The main aim of the Government is to reduce the effect of taxation upon the incentive to invest and ensure that the fiscal system as a whole will not, per se, hamper development.

In Egypt as in most less-developed countries, the tendency of the potential investor to bear risk is very low. Most investors prefer to invest their savings in a secure type of investment such as Government Bonds, land and housing. The Land Reform of 1952 restricted the land tenure by 200 feddans and, therefore, investment in agricultural land which was the most favourite type of investment in Egypt during the last few centuries has been limited and/or legally eliminated. Investment in housing has also been subject to restrictions lately as the building of new houses came under Governmental control concerning the permission to build. On the other hand, the Government policy was always to encourage public borrowing through issuing tax-free bonds with a remunerative interest rate.

The outcome of the above factors, or in more precise words, the result of the economic and other measures undertaken by the Government

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1. The exemptions of newly formed enterprises from the Schedular Income Tax is considered in detail in Chapter VI of this work.

2. Machinery and certain raw materials are exempted or subject to a small rate of import duties as an inducement to establish new industries in Egypt. See, The Budget Reports, 1953/54 and 1954/55, Ministry of Finance and Economy, Republic of Egypt.

was the shift of a considerable part of private savings towards public investment through public loans. From Tables 3 and 6 we can observe this fact; public investment rose continuously except in 1952 (the year marking the change of the political regime). This partly accounts for the growing government deficit.[1] On the other hand, gross private investment declined steadily while private savings increased in the same period. Generally speaking, the increase in public investments have been counterbalanced by a decrease in private investment.[2] Since 1954 the public debt has increased steadily.[3] Taking total public loans in bonds, the amount was £E123m. in 1953, increased to £E135.5m. in 1954, to £E147.6m. in 1955, to £E174.7m. in 1956 and to £E180.3m. in 1957. During the same period, part of these bonds, the Cotton loan, was re-:deemed, while new Development Loans were issued as well as Agrarian Reform bonds.

From the foregoing analysis we find that private investment is declining steadily which might be attributed to a certain extent to the failure of private individuals to undertake risky ventures and, therefore, the Government had to step in. Generally speaking, the present policy of the Government to finance development programmes is dependable on deficit financing as well as a limited amount of foreign loans (except that offered by the U.S.S.R. to finance the first stage of the High Dam, about £E32m.).

The effect of income taxation, however, is not of great importance to the private investor as the relatively low rate of the income tax on Commercial and Industrial Profits, i.e. 17% besides the complete exemption

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1. U.N., Economic Developments in the Middle East, 1956-57, p. 13.
2. Ibid. p. 13.
3. See Table 7, p. 14

of new enterprises from income taxation did not help to stimulate capital formation.[1] Therefore, one could emphasise that there are more powerful factors other than taxation which were the cause of the decline of private investment. Private foreign capital is still in a hesitant stage in spite of the fiscal measures provided during the last few years. Needless to say, it is apparent that fiscal measures, especially income tax incentives, have no tangible effect on foreign capital formation, but it is believed that there are other various political as well as economic factors involved in this connection.

III. Income Taxes and Economic Stabilisation.

The problem of economic instability due to the business cycle has caused a great discomfort to most governments. Economists since the 1930's have tried their utmost to discover adequate measures to deal with such instability and, therefore, various studies took place and various solutions were put forward. Fiscal as well as monetary measures were conducted and channelled to deal with and investigate the severity of the business cycles. Tax measures, as an important part of a counter-cycle fiscal policy, have been unanimously advocated as an effective device for combating business fluctuations and their consequencies.

Income tax has proved to be an adequate fiscal measure in stabilizing the economy and hence reaching the equilibrium point where full employment is maintained. Its influence in checking the serious effects of the business cycle is more apparent in a developed economy, while it has a relatively inferior importance in a less-developed economy. This is

1. Domestic double taxation has been eliminated through the exemption of dividends from the Schedular Tax on Commercial and Industrial Profits. Moreover, the Law provides for losses carried forward for three years.

attributed to the low standard of living as a consequence of the overwhelming low income per capita, which in many cases just reaches the subsistence level in underdeveloped countries. This significant phenomenon has to be borne in mind in planning the counter-cyclical measures. In an underdeveloped economy indirect taxes are considered a relatively more "influential" device than direct taxes in stabilizing the economy, while in developed economies the reverse may be the case.

The flexibility of an income tax as a fiscal counter-cyclical measure depends mostly on the rate schedule and reliefs which affect directly the tax liability. The comparative efficiency of various changes in the rate schedule on the tax base due to modifications of reliefs could be measured by the multiplier effects of a tax increase or decrease - that is, by the relation between the amount of tax changes and the resulting increase or decrease in the aggregate demand.

Changes in personal income tax are argued to have a greater effect on the business cycle than an income tax on business profits. Business tax liabilities are directly related to the success or the failure of the business itself. Thus a firm obtains an automatic reduction or increase in income tax depending on the trend of the economy, i.e. prosperity or recession. For the Treasury this means that the yield of business income tax automatically declines during the depression and increases during recovery. Therefore, it is believed that other taxes, particularly taxes on sales, production, or cost factor, would be more deflationary than business income taxes, "that would yield the same amount of revenue over a complete business cycle".[1]

1. National Bureau of Economic Research, Policies to Combat Depression, paper prepared by R. Goode on "The Corporate Income Tax in a Depression", pp. 150-170.

One of the most important factors which should be carefully considered is the timing element in applying any fiscal or monetary measure. Any tax change has to be timed so as to render its expected fruits at the appropriate time without having an adverse repercussion. Tax cuts during a recession have to be carefully put into power at the appropriate time, otherwise it might start an inflationary trend. In the meantime, tax changes should be closely appropriate to changes in the rate of spending. Another problem which faces the administration is what could be called the "announcement problem". By this I mean that any change in tax provisions has to be decided by the people's representatives, as is the procedure within a democratic system. Therefore, the announcing of the proposed changes in taxes could have an adverse effect, as some taxpayers might try to act in a different way in order to obtain a future benefit.[1]

Income tax reliefs and exemptions as well as the tax rate are the most important tools upon which the economist depends in stabilizing the economy.

The following is a brief account of the basic income tax reliefs, personal and business, and their role in mitigating the severity of the business cycle:

1) Changes in personal exemptions, either in the exemption limit or in other personal reliefs, such as dependants' reliefs, etc., are considered as an effective tool in changing the tax base. This change is usually coupled with a change in the rate structure. During inflation the personal exemption limit is reduced in real terms and thus the actual

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1. For example, if a new Capital Allowance (such as the Initial Allowance of the British Income Tax) on new capital assets is proposed to encourage investment during the recession, this might lead to a postponement of expenditure on capital goods which, in turn, might intensify the recession.

tax becomes wider. In the depression a reduction in the tax base as well as in rates provides an adequate measure in reducing the tax liability and thus increasing the disposable income which consequently increases the demand schedule. As it is the same in other fiscal measures, the timing problem raises an important question in choosing the appropriate time to start such changes. The timing problem in this very measure is not so difficult as it is in other fiscal measures. This is true because in most income tax systems, the fiscal year of all individuals is the same, therefore, the authorities have only one date for the application of such changes, that is, the end of the fiscal year.[1] During the depression tax cuts of appropriate size and at the appropriate time ought to be produced as promptly as possible once a cyclical contraction has actually begun. The installation of unnecessary tax cuts must be avoided on principle, and particularly because in unfavourable conditions they may result in inflation.

2) On the first appearance of the downtrend of the economy unused personal exemptions and reliefs could be carried backwards against previous taxable income.[2] This would help in mitigating the cyclical effect. The carry-back method would create a negative tax liability; a subsidy in the shape of a tax refund. The feasibility of such a measure depends mostly on its practicability from the administrative point of view. After recovery a permanent averaging method, either carry-forward or carry-backward of unused exemptions achieves a stable revenue to the Treasury and establishes greater

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1. The government has the choice between the end of the current fiscal year in undertaking the desirable changes or to wait another twelve months.

2. W. Vickrey, Agenda for Progressive Taxation, pp. 189-191.

equity.

3) Methods used for inventory valuation are considered as an important factor in influencing the fluctuations of aggregate business profits. During a recession the adoption of Fifo method reduces the fluctuations in reported business profits and tax liabilities will fall less rapidly than under Fifo method, as under the latter method "the lag between assumed cost of goods sold and replacement cost becomes important in a period of rapidly changing prices".[1] Consequently Fifo appears to be a relatively adequate method for stabilizing the economy and reducing the sharp fluctuation in profits or losses due to price changes of inventories.[2]

4) Accelerated depreciation could be used as an anti-cyclical device if used after a careful study of its direct and indirect effects on the tax system especially if used as a tool for tax avoidance. Rapid amortization of depreciable assets reduces net profits subject to tax and thus results in greater disposable income to be distributed as dividends, or, if not distributed will increase the funds available for expansion and further investment. The ultimate effect depends on the difference and thus the difference which would result, pari passu, in the multiplier effect in each portion. By and large, the effect of accelerated depre:ciation on depression will depend on various factors, e.g. on future tax rates, on the availability of loss-carry-backs or carry-forwards and on the difference between the "pay-off period" and its useful life.[3]

The change in prices, if taken into account in the computation of the depreciation allowance, affects the cyclical fluctuations. The adoption

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1. National Bureau of Economic Research, op. cit., p. 153.

2. H.B. Arthur, "Inventory Profits in the Business Cycle", American Economic Review, March, 1938, p. 28. Also see, J.K. Butters, Inventory Accounting and Policies, pp. 124-125.

3. Ibid. p. 164.

of replacement-cost depreciation during an inflationary period will result in an undesirable effect; it will increase the disposable profits after tax which include special reserves accumulated through the application of replacement-cost depreciation. If such amounts are distributed it will increase the intensity of the cycle through its effect on the propensity to consume. If undistributed, such profits would increase the propensity to invest, which in turn, through the multiplier effect, would raise the demand schedule to a higher level. A desirable compromise could be found to solve the above dilemma and to bring together the two aims, equity and combating the inflationary trend. The excess of depreciation allowance computed according to replacement cost over the normal depreciation allowance could be transferred to a separate account which should not be used unless the asset is completely amortized or unless permission is granted, before the asset's complete amortization by the Treasury. In other words, the "excess depreciation allowance" should be controlled by an authoritative body well informed on the trend of the economy in general.

Replacement-cost depreciation might be an additional obstacle to investment during depression when prices are expected to decline, as future deductions would be smaller than under original-cost depreciation. But if prices are expected to rise, in the case of a short-run recession, the adoption of replacement-cost depreciation would be more feasible for firms to invest in depreciable assets.

5) During the depression a special tax on undistributed profits; or any fiscal measure which differentiates against retained profits, stimulates additional distribution of dividends and thus increases aggregate consumption expenditure. The adoption of any method which differentiates against

undistributed profits during inflation would intensify the upward trend by increasing disposable income and hence consumption expenditure. Therefore, such differentiation ought to be suspended at the first stage of recovery.

These are the main income tax tools used in mitigating the rigidity of the business cycle. In underdeveloped countries, as previously mentioned, the role of income taxation in eliminating the maleffects of the business cycle is of minor importance, due to the fact that a small fraction of the population is subject to income taxation. Generally speaking, it has been strongly argued by the majority of economists who are interested in problems of underdeveloped economies, that the effect of monetary as well as fiscal policy measures in the business cycle is limited.[1] This unfortunate fact is due mainly to several reasons, the imperfection of the price system; the inefficiency of the administration in general and that of the taxation in particular, the low income <u>per capita</u>; the inelasticity of the consumption function, e.g. consumption is a unity for the majority of population; the low income groups; the poor and underdeveloped banking institutions; the predominance of non-monetary economy, and various other factors.

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1. "The normal monetary policy open to a Central Bank for counteracting inflation is also subject to serious limitations in an underdeveloped economy:

a) The banking system is not sufficiently highly organised for the bank rate to be effective ...

b) The bank money which is directly influenced by the rate of interest forms only a small proportion of the total volume of money in circulation ...

c) Private investment is not in most cases directly related to the consumption. Not to speak of the agricultural sector where the banking system hardly plays any role, even in industries a large part of the finance is often provided by agencies which are virtually independent of the banking system ..."

"Few countries in the region have so far made any significant progress towards disinflation by fiscal measures. These are certain limiting factors:

a) Income tax coverage in these countries is very small and insufficient to enable revenue from direct taxation to cope with extraordinary demand on the Exchequer ...

b) Corporation taxes are limited in most countries by incentive considerations ...

c) Proposal to increase indirect taxes, although they deserve the most serious consideration, meet the following dilemma: the proceeds of indirect taxes on luxuries do not increase as rates are increased, the demand for these goods being elastic, on the other hand indirect taxes on necessaries are inequitable. Consumption taxes are regressive as they fall on the poor as an inflationary rise in prices. Yet they cannot be carried beyond a certain limit in view of possible repercussion on wages."

Cf., U.N., <u>Economic Bulletin for Asia and the Far East</u>, Third Quarter 1951, Vol. 11, No. 3, Bangkok, February 1952. See also a brief comment on this topic in G.M. Meier and R.E. Baldwin, <u>Economic Development, Theory, History, Policy</u>, New York, 1957, pp. 301-303.

The Egyptian Income Taxation and Economic Stabilization:

Now we turn to the role of the Egyptian income taxes as a stabilizer. Before indulging ourselves in the fiscal discussion, it is desirable to give a brief idea about the factors behind economic cyclical fluctuations in Egypt.

The fact that cyclical developments in Egypt are so strongly influenced by cotton prices is explained by the predominance of cotton as the major export crop in the economy. In broadest terms, the typical pattern of the Egyptian economic cycle may be summarised as follows; when demand in world markets rises, the price and total value of cotton exports go up. Higher profits and wages in the agricultural sector are translated into greater domestic demand. The rise in the money supply that results from the active turn in the balance of payments, together with the growing volume of credit, intensifies the domestic expansion. Government revenues increase, the value of real estate and other assets rises, and speculation contributes further to the general increase. The turn comes when the world market begins to contract. The value of exports then falls off, the balance of payments turns passive, the money supply shrinks, prices, wages and profits go down. Government revenues also shrink and a high percentage of unemployment may set in, until the world demand once more increases.

Needless to say, the range of action open to the Government, in this connection, goes far beyond the fiscal field. In fact, measures relating to international commercial policy, labour policy, and agricultural policy may, under certain circumstances, prove more feasible and also more effective than fiscal action as an anti-cyclical measure. In this study, however, it will be necessary to limit the discussion to fiscal field in general and to income taxation as part of the fiscal system in particular.

The Egyptian income tax was levied at the start of the World War II and, therefore, it has only experienced an upward trend up till the present time. The major cause of the inflationary pressure during the War period was due mainly to Allied military expenditure, which was aggravated during some years by a considerable reduction in the volume of imports.[1]

Income tax rates were increased few times during the war period and reached 12% on income derived from negotiable capital and on commercial and industrial profits. The Excess Profits Tax was levied in 1942 with the intention of curbing the inflationary trend and supplying the Treasury with revenue needed to meet the rising public expenditure. While direct taxes increased in percentage to total public receipts, indirect taxes, especially custom duties, declined during that period. The increased importance of direct Taxes during the war years reflected only a temporary phenomenon largely due to the decline in customs receipts as a result of reduced imports.[2] Public debt, on the other hand, has been relatively in a constant condition during that period; total public debt was £E93.2m. in 1940 and increased to £E101.8m. in 1942 (the increase was due to the floating of 4% cotton loan to finance that year's cotton crop), and then dropped to £E93.4m. in 1945. Generally speaking the Government did not undertake effective fiscal measures, i.e. taxation measures, to

1. "Wholesale prices tripled during the war years while the money supply (notes in circulation and deposits) expanded to seven times its 1939 volume. See, U.N., Public Finance Information Papers, Egypt, 1950, p. 1. Allied military expenditures totalled £E314m. from 1940 to 1945 inclusive, See, U.N., Economic Developments in the Middle East, 1945-1954, p. 27.

2. See, U.N., op. cit., Table 3, pp. 24-27.

counteract the inflationary pressure due to the war conditions other than the levying of the Excess Profits Tax.

Table 19 shows us a very interesting phenomenon which existed during the war period in the Egyptian economy. While the Government realised a surplus for the last four years of the war (the surplus is sterilised as soon as it is transferred to the General Reserve Fund) which meant the absorption of part of the purchasing power from aggregate demand, we observe a steady rise in the cost of living index. This contradictory deduction shows that fiscal measures were inefficient to curb the inflation-:ary trend. This also means that there were other much stronger factors working in the other direction; they could be:

(a) the sharp and continuous increase in the money supply due to the increase in the Allied military expenditure; it increased to sevenfold of the pre-war amount; (b) the lag of domestic production behind the increase in demand due to the sharp decline in imports and the sharp increase in the purchasing power due to the military expenditures; (c) taxation in general did not absorb a sizeable part of the purchasing power due to the inefficiency of administration. It is true in the latter condition if we realize that the E.P.T. levied on war profits during that period was not collected fully until in later years, say, five to seven years after the realisation of the profits.[1] (d) The public debt, as previously mentioned did not play its role in the fight against inflation; it remained constant.

This brief analysis shows the inefficiency of the fiscal system to curb the inflationary trend during the war period; which it was chosen to serve as a test for our investigation. As a matter of fact a final

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1. See, Chapter 3, pp. 80-85.

Table 19. **The Efficiency of Taxes on Income on the Inflationary Pressure During World War II.** £Emillions.

Item / Year ending 30th April	1940	1941	1942	1943	1944	1945
1. Total Public Expenditure:	41.17	42.56	46.06	56.55	71.94	82.10
a. Current Expenditure	31.87	37.08	41.28	52.42	61.52	73.03
b. New Works	9.30	5.48	4.78	4.13	10.42	9.07
2. Total Public Revenue:	39.40	43.68	56.33	67.14	77.77	87.73
a. Schedular Income Tax	2.69	2.05	3.20	5.79	7.59	7.48
b. Excess Profits Tax	-	-	0.56	5.55	6.46	5.96
3. Budget Surplus or Deficit	-1.77	+ 1.12	+10.27	+10.59	+5.83	+5.63
4. Cost of living index (1939=100)	113	138	184	242	279	293
5. Yearly change in the cost of living	13%	25%	46%	58%	37%	14%

Source: U.N., Public Finance Information Papers, Egypt, 1951.

judgment of the Egyptian fiscal measures should not be confined to such a period as income taxationwas still in its first experimental stage and also that the Government, at that time, did not seek other fiscal measures to fight the upward trend, such as the absorption of the excess purchasing power through public borrowing and maximizing the efficiency of the tax machinery.

The post-war period was earmarked by a decline in the cost of living and a deflationary trend was in the march. Taxes remained at the same level regarding the rates up till 1950 while their yield rose during that period especially customs duties due to the increase in imports and the rise in the national income. During the Korean boom the cost of living index rose and it declined slightly afterwards; it rose from 282 in 1949 to 306 in 1950, to 328 in 1951 and then declined to 296 in 1952.[1] Generally, analysis of the inflationary and deflationary pressures which made themselves felt in the post-war period shows that the main factor has been the variation in the price of the Egyptian cotton in world markets and the consequent effects on the balance of payments.[2] In spite of the increase in tax rates, especially income taxation, and the introduction of the General Income Tax in 1949 the general effect of this increase was not felt in the economy as prices did not fall considerably even after the end of the Korean War in 1953; while, as a matter of fact, it rose steadily from 1956 due to the Suez crisis of that year and to the expansion of development programmes carried out through deficit financing.[3] "The

1. National Bank of Egypt, Economic Bulletin, Vol. IX. No. 3, 1956 p. 293.

2. U.N., Economic Developments in the Middle East, 1945-54, New York, 1955, p. 46.

3. Cost of living indices were 283 in 1955; 297 in 1956; 306 in 1957 and 301 in 1958. See, National Bank of Egypt, Economic Bulletin, Vol. XII No. 1, 1959, p. 67.

foreign sector in Egypt seems to have acted as a shock absorber in its over-all stabilizing effect on the economy, particularly in counteracting the effects of domestic fiscal policy".[1] Consequently, fiscal policy through tax measures especially income taxation, have a minor effect on stabilizing the economy in the post-war period, even if we take into consideration the fact that taxes absorb a considerable part of the national product compared to other less-developed economies; it is between 22% and 25% in Egypt (income taxes compose only a small propor:tion of total tax revenues, about 15% to 17%).

1. U.N., Economic Developments in the Middle East, 1956-57, New York, 1958, p. 16.

Chapter VI

The Role of Exemptions in the System

I. Motives Behind Exemptions

Fiscal jurisdictions have from time to time felt it desirable to encourage certain types of economic, social and cultural activities. Stimulating economic development, encouraging social and cultural institutions to spread and widen their scope of activities, and attaining equitable distribution of the fiscal burden, governments felt it appropriate to grant various tax privileges in the form of exemptions and reliefs to attain such objectives. In this chapter and the following (Chapter 7) we are concerned with the role of exemptions, business or personal, in reaching the tax objectives. By and large, exemptions are considered as basic 'tools' which any income tax normally uses to reach its objectives. Therefore, in our view a special section of our enquiry into the performance of the Egyptian income tax system has to be devoted entirely to this special case; the role which exemptions play in the system.

This chapter deals with the main objects of income tax exemptions, which can be divided into four categories; a) increasing equity in the distribution of the tax burden, b) achieving economic objectives, c) political objectives, and d) administrative reasons.

As our principal object in the study of the performance of the Egyptian income tax is to see how far the system has reached its objectives, it seems more appropriate to concentrate on the discussion of the first two categories of exemptions; i.e. exemptions for equity, and those for economic development. On the other hand, political exemptions are considered to be of less significance to our enquiry, as the only exemptions based on political motives are those granted to the members of diplomatic missions on a reciprocal basis.[1]

Exemptions for administrative reasons are usually based on the well known 'maxim of economy' laid down by Adam Smith.[2] However, the motives behind this type of exemption are mainly two: 1) Avoiding uneconomical collection expenses. Therefore exemptions are usually granted on grounds of expediency, where it can be proved to the revenue authorities that if these exemptions are not granted, the collection expenses of the tax from unexempted taxpayers will prove uneconomical. Administrative costs, on the whole, should take into consideration "compliance costs" besides collection expenses. The tax productivity should be compared with administrative costs to verify the adequacy of the tax. Applying this principle, it is obvious that income tax usually exempts low income groups so as to achieve social as well as administrative objects. 2) Difficulty of assessment accounts for another category of exemptions. In almost all under-developed countries the revenue authorities find it difficult to assess income taxation from a considerable section of population, as the non-monetary income in the agricultural sector is difficult if not impossible to assess.[3]

These are the basic reasons for administrative exemptions, with which we are not largely concerned at present, as we have pointed out before, (Chapter III) the principal difficulties of the tax administration in Egypt, and we need not therefore rediscuss these difficulties. By and large, as we mentioned before,

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(1) There are no exemptions of the Sovereign at present, since the 1952 Revolution when ex King Farouk abdicated.

(2) "---- every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state," Adam Smith, Wealth of Nations, Book 5, Chapter II.

(3) On the point of administrative difficulty of assessing income taxes in Egypt see Chapter III.

the main aim of this chapter, and the following one, is to demonstrate and analyse the role of exemptions in achieving equity and economic development of the Egyptian economy. This study, however, can be more approximately considered as an indispensible supplement to the previous chapters, (Chapters III, IV and V) in which we have already discussed the performance of the Egyptian income tax without putting much emphasis on the role of exemptions in the system. Therefore, it seems necessary to clarify the place of exemptions in order to complete our study into the performance of the income tax.

= A = Equity Motives

Tax exemptions based on equity considerations are widely accepted as they are usually founded on a humanitarian basis. Our analysis is confined only to the major reliefs usually granted through the income tax legislation of most developed as well as less-developed countries.

(1) Exemption of Minimum Subsistence:

The Physiocrats, who advocated the single tax on land, opposed any tax on income, especially that which was derived from labour. Their main reason was that any tax, other than land tax, on the labourers will be harmful to human nature, because if the tax levied absorbs a part of the labourer's income, he will suffer from hunger and illness. This will lead to a shortage of the labour supply which, in turn, will lead to higher wages for the others. The incidence of the higher wages will be shifted to the price of the commodities produced. Consequently, the demand for labour will increase as a result of shortage of supply, which will raise the standard of wages above its normal level to compensate the income tax. In general, they opposed any tax on any income rather than income derived from land on the basis that a labourer's income is just enough for his subsistence, hence any tax to be levied on this income will cause destruction to the nation as a whole.

Adam Smith, Ricardo and J.S. Mill felt the need for leaving a certain minimum of income untaxed, sufficient to provide the necessaries of life to the taxpayer and his family.

Later, the principle of exempting the minimum of subsistence has been accepted by numerous economists in different forms and on different grounds, while other economists, a minority, rejected it on politico-economic grounds.

What is meant by minimum of subsistence?

A minimum of subsistence is a necessary cost for the population in a specific country. A certain minimum of income may be defined as that amount of income, real or imputed, necessary to meet the cost of maintaining the average population. To reach the subsistence income, we need accurate statistics of different indexes, such as the index of cost of living, the index of prices, wholesale and retail, and other reliable statistics which will help in computing the minimum.

Findly Shirras described the subsistence minimum as "the necessaries for efficiency."[1] It means that all the necessaries such as nourishing food and housing must be exempted from taxation. The number of dependents supported by an individual should be taken into consideration in determining the minimum.

Minimum of subsistence does not consist only of money income but also comprehends special commodities and properties. Homestead exemption in the property tax field are based partly upon the idea of leaving a minimum free from tax. The exemption of food and other extreme necessaries under the sales tax or import duties can be placed in the same category.

The minimum of subsistence exemption must be based on a minimum standard of living of a certain country. What is meant by a minimum standard? Does it only comprise the necessary food and housing for the existence of the human being, or does it include other things? This question is still a debatable

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(1) F. Shirras, The Science of Public Finance, p. 132.

subject. Seligman answered this question: that if taxes are levied on the labourers when wages are even higher than the minimum of subsistence, their standard of living will be lowered.[1] If income earners of a certain country are accustomed to participate in the general progress of the society, and are enjoying the comforts of modern life, i.e. cinemas, theatres, athletic clubs, obtaining wireless sets, television etc., the minimum will naturally be much higher than a country with a low standard of living. It has been obvious during this century, with the development of democratic ideas, that the limit of exemption of the subsistence minimum is inclined to rise continually.

The minimum of subsistence is mainly dependent on the standard of living of the people of a certain nation; a country whose people enjoy a relatively high standard of life may recognise what would be luxuries for an under-developed nation as necessaries and vice versa.

Arguments for tax-exempt minimum of subsistence.

Most of the economists advocated the exemption of the minimum of subsistence from taxation for the achievement of equity, expediency and other reasons. As above mentioned the basic reason for the exemption of a minimum of subsistence is usually founded on the assumption that a given supply of population must be maintained at a certain standard of living. This result is based on the principle that taxation should not disturb the fundamental forces that determine population and that taxation should not alter population tendencies while trying to avoid reduction in productivity.

Some other economists advocated the doctrine on the grounds that as the cost of production includes many items which are to be deducted to reach the taxable profit, (among these items is "the meat and bread for the labourers which were regarded very much as fuel shovelled into the furnace of a human machine"[2]), it

(1) E.R.A. Seligman, The Income Tax, p. 28.

(2) C. Plehn, Introduction to Public Finance, p. 112.

would be burdensome for production to tax the necessaries of the productive power, and if the minimum income is taxed the tax would certainly be shifted.[1]

If the government imposes taxes on the minimum of subsistence, the general trend of the population will decline and the poor get poorer. In other words, the tax on the minimum of subsistence tends to create paupers and to lower the standard of living which will aggravate the general social situation of the nation. This condition will force the government to establish a policy of poor relief and the result will be taking the money away with one hand and returning it with the other.

It has been argued that to observe the principle of economy in the costs of collecting small driblets of revenue from the poorest classes, the exemption of the subsistence income must exist. This fiscal reason is based on the ground that the cost of collecting the taxes from paupers may be prohibitive compared with the revenues obtained.

The exemption of the subsistence income is based on social justification; that allowing such exemptions would mitigate present inequalities and tend to lessen inequalities in the distribution of income and probably in wealth. As equity, in matters of taxation, is based on the equal distribution of the tax burden measured by the ability to pay, the individual taxpayer liable to taxation on his subsistence income will bear an excessive burden, while his ability to pay any tax is nil.[2]

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(1) The Physiocrats, Ricardo, Mill and some of the later economists have stated that taxes on subsistence minimum tend to be shifted from the poorest elements of the society to the richer classes through readjustments in the population supply and increases in wages. Taxes on the bare necessities of existence raise their prices in the long run and thereby lessen the purchasing power of wages. At the end taxes will be shifted to the rich through higher prices of commodities resulting from higher wages.

(2) It started in the British system by the avoidance of duties on the necessaries of life, and incomes up to £140 per annum are free from direct taxation.

Consequently a considerable burden of commodity, business and property taxes is shifted into consumption expenditure, where it bears heavily on the poor class, and therefore a substantial minimum exemption in personal taxes counterbalances the maldistribution of the fiscal burdens.[1]

In general, all tax systems of different nations exempt the subsistence income from taxation for one or more of the reasons mentioned, mainly on humanitarian grounds.

Arguments against the exemption of the subsistence income.

One of the basic arguments against the exemption of the minimum of subsistence is the loss of revenue as huge numbers of taxpayers will escape the tax payment. This argument could be surmounted on the ground that the cost of collection from the big masses of population will overweight the revenue collected.

Some economists argued that the existence of the State depends on the tax revenue just as the individual relies on food. Thus the minimum of outlay for existence must include the necessary expense of the State. This statement is groundless, because it will be against the approved doctrine, ability to pay. So, if the tax is levied on those who barely possess the means of subsistence and have no ability to pay taxes, the result would be to drive them into misery and poverty. Then the government will find no other alternative than to establish a program of poor relief.

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(1) Consumption taxes compose a considerable part of the individual income in general. In U.S.A. for example, an individual paid in 1944 an average of \$ 25.55 for the Federal purchase tax levied on cigarettes and \$ 10 a year per American family for the sugar tariff. Under a 2% retail sales tax an individual pays \$ 20 in taxes for every \$ 1000 spent on taxable merchandise. H. Groves; Financing Government, p. 295

The political argument against the exemption of the subsistence income is based on the doctrine of "no taxation without representation". In the democratic system taxes are levied after being approved by the taxpayers through their representatives in parliament. Each member of the society who enjoys the power of voting should contribute to the expenses of government, even though the contribution is small; moreover, this exemption of tax has been criticised on the grounds that it would extend favours to certain classes at the expense of others. This objection is denounced on the basis that this type of exemption, like most of the reliefs, is given to taxpayers to achieve one of the most significant principles of taxation - equality in the distribution of the tax burden between the citizens.

The most logical argument advanced by some economists is that State expenditure may be more productive than private expenditure, and that the gains of the poorest classes from the taxation of their subsistence income may be greater than the sacrifice they suffer through taxation. This objection is not always correct. Taxes are collected to meet the government expenditure in general and the government does not allocate the taxes according to the class who paid them, but all government revenues from taxes, fees and other sources are mixed and directed to meet the different government expenditures. No accurate statistical measures could ever be reached for choosing between taxing the subsistence level or exempting it according to this argument.

The exemption of a minimum of subsistence may stimulate evasion by individuals, but such evasion already exists in the failure to collect different taxes which taxpayers owe to governments. In addition, it is very difficult to verify the account statements of small taxpayers for purposes of exemption, especially in income taxation. Thus the tax authorities have to depend largely on their honesty and their fiscal consciousness.

The major objection or the most difficult problem is the measurement of the minimum standard. To decide the least physiological minimum or the lowest cost of subsistence depends upon different elements, such as the standard of living, income of the community, cost of living, changes in consumption habits, number of dependents and many other particular conditions.

Another difficulty in measuring the minimum is that governmental revenues are not derived only from personal income tax, but a great variety of taxes is collected and most individuals, poor or rich, take part in paying one or more of the taxes. Therefore an acceptable minimum will be relatively arbitrary and have to be measured roughly.

Forms of minimum exemptions.

The exemption of minimum of income may take one of the following forms:[1]

(a) 'Lump sum' exemption allows a deduction of a certain amount from the taxable element but if this element exceeds the sum exempted, the whole amount will be liable to tax. For example, if the fixed exemption is £100, the income above £100, e.g. £101, will be entirely subject to tax.

(b) Continuing exemption permits the deduction of the full amount of the exemption without any respect to the amount of the taxable element. If £100 is the amount exempted, a sum of £500 or £1000 will enjoy the privilege of deducting the full amount of exemption, the £100. This form of exemption reduces the taxable income and it would have a multiple effect in the case of progressive rates.

(1) W.J. Shultz and C.L. Harris, American Public Finance, p. 262.

Allowing minimum exemption to rich taxpayers is a diversion from the principle of minimum exemptions and causes a reduction in the tax yield while the lump sum exemption is inequitable. It could be said that both types contradict each other and they are rarely used in tax systems.

(c) Vanishing exemption: under this form, the exemption diminishes as the tax base increases over the exemption level. If the exemption level is £100, a person with an income of £200 would enjoy a £50 exemption, while an income of £300 would be fully taxable. This type eliminates the disadvantages of both the lump sum and the continuing exemptions.

Consequently, the exemption of minimum of subsistence is a necessity and it is largely approved for its equity and expediency. The most significant difficulty involved in the determination of the minimum is its measurement. Legislators and politicians, as well as economists, should devote their efforts to devising a scientific measurements of the minimum of subsistence. Another conflict may occur to legislators and economists between productivity, which is one of the most important practical considerations in taxation, and equity and social justice. It is definitely preferable to avoid creating paupers by indiscriminate taxation than to tax them on their subsistence and then repair the damage by expenditure for poor relief. Great social damages are involved in the heavy taxation of the lowest classes. Specific considerations should be given to the tax burdens of the poor in periods of economic depression, while in such periods, governments are most in need of revenues. A wise tax system should try to avoid taxing the subsistence level and search for other adequate sources of revenues.

The Egyptian practice:

Since the imposition of the first Egyptian Schedular Income Tax in 1939 the exemption limit did not change. The same situation is found in the General Income Tax which was imposed in 1949, (see Table 20). In spite of the various changes in the price levels during and after the World War II no action was taken to alter the exemption limit. From Table 20 we find that the cost of living index has been rising steadily from 100 in 1939 to 298 in 1957. This phenomenon shows at the first place the lag of the exemption limit behind the continuous rise in the cost of living. While this might be unjustifiable from equity view-point especially when considering wage earners whose income did not rise by the same proportion as that occurred to individuals who derive their income from other sources, e.g., commercial and industrial profits, land rent and agricultural profits, moveable property ... etc. It is perfectly true that salaried employees and wage earners have suffered mostly from the unjustifiably low exemption limit especially those who have dependents to support.[1] Moreover, such class of taxpayers are considered to be the most honest class between all income taxpayers as the tax is automatically withheld at the source, while others could evade the tax, partially or completely, by various ways and means.

The General Income Tax provides an exemption limit of £E 1,000 for a single person and £E 50 for his wife and every child with a maximum of £E 200. The study of the G.I. Tax during its short period of application results in the fact that the existing limit of exemption is higher than it should be for the following reasons:

(a) A considerable percentage of income especially that derived from agricultural land and buildings, is computed on arbitrary basis. The Egyptian property taxes

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(1) Taking the Government employees as example, their salaries are increased only by 25% to meet the increase in the cost of living. The situation is worse as most of the employees nowadays do not in fact cash such bonus for various administrative reasons.

upon which the income liable to the G.I. Tax is based, are assessed on the estimated annual rental value of the asset and not on the actual income. Moreover, the G.I. Tax is assessed on the rental value after the deduction of a fixed percentage; 20% for administrative expenses, repairs and depreciation. Property tax already paid is allowed as a deduction from the estimated income of the property. This deduction leads towards the under assessment of the tax of those who derive most of their income from immovable property, while those who derive their income from wages and salaries, trade or from professions pay the tax on their actual earned income. Consequently, the individual who enjoys unearned income is in a better situation than someone who obtains his income from work whereas it should be the opposite.[1]

(b) The treatment of income derived from land would result in the decline of net revenues of the G.I. Tax as the majority of the landowners, 94%, hold not more than five acres, while those who own more than 100 acres are about 5083, or about 0.2% of total landowners.[2]

(c) The cost of living is by no means as high as £E1000 a year for the average Egyptian. According to the above factual evidence I believe that the exemption limit in the G.I. Tax ought to be reduced to about £E300 with the revision of the provisions relating to allowances for depreciation, administrative and other major expenses.

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(1) If A derives £E4000 a year from his land (according to estimated rental value), and B derives the same amount from his business as a tradesman (joiner for example), the first has to pay £E704 in direct taxes (£E560 Land Tax + £E144 G.I. Tax), while B has to pay £E892 (£E680 Schedular Income Tax + £E212 G.I. Tax). The effective tax rates are 17.6% and 22.3% respectively. This example illustrates the unfair treatment rendered by the differentiation of the way of assessment of the different of income, inasmuch as the double reliefs granted to income derived from property, especially in the case of buildings, (the Tax on Buildings allows 10% deduction for depreciation and repairs).

(2) See Table 1.

TABLE 20

The trend of the exemption limit, single person, under the Egyptian Income Tax system, and the social services per capita within the period from 1939 to 1957

Item	1939	1942	1945	1948	1951	1954	1957
Exemption Limit (Sch. Taxes)[1] £E	100	100	100	100	100	100	100
Exemption Limit (G.I. Tax)[1] £E	-	-	-	-	1000	1000	1000
Cost of Living Indices	100	185	293	281	319	284	298
Per-capita share of social services £E	0.4	..(4)	..(4)	0.9	1.4	1.5	2.2(5)

Notes: (1) Most Schedule Taxes have one exemption limit, which is £E 100 for a single person, but in the case of the Tax on Income from moveable Property there is no exemption limit as this tax is regarded too impersonal.

(2) The G.I.T. came into force in 1949 but the majority to taxpayers (i.e. Schedular income tax-payers are not liable to this tax as their incomes are mainly below the G.I.T. liability point.) Therefore, any attempt to form a judgement based on the G.I.T. exemption limit is inadequate and misleading as this tax affects a small fraction of the population.

(3) The calculation of this item is based on various assumptions which might seem impracticable or unrealistic. However, for simplification and expedience, I find myself compelled to assume that; a) all population, children and adults, receive the same share of total social services' expenditure; b) that a single person obtains the same amount as any other person in a different civic status; and c) the aggregates of social services' expenditure are in current prices.

(4) Figures unavailable.

(5) Budget estimates.

Sources: Republic of Egypt, Statistical Pocket Year Book, 1957; and, National Bank of Egypt Bulletins, various years.

Income from property should be based on actual basis not on the rental value which is calculated every ten years as in the case of agricultural land and nine years as in the case of buildings.

The general outlook, at present, of the Egyptian income tax system regarding minimum allowance is that such exemption is static and does not follow any change in the social and economic circumstances.

Closely related to the exemption of the subsistence income is the allowance deducted from taxable income for the upkeep of children and dependents. In order to achieve horizontal equity doctrine most of income tax systems permit the deduction of a certain amount of the individual's income for each dependent. The Egyptian tax is no exception. The Schedular Tax allows a lump sum £E30 for children whatever their number is, while the G.I. Tax allows £E50 for each child with a maximum of £E150 (no exemption is allowed for more than three children).

As the family unit within the Schedular Tax is of minor importance because of the impersonal characteristic of the tax, the writer believes that the amount allowed as a deduction for children could be considered sufficient for the time being. But on the other hand, the major defect lies within the G.I. tax where the personal touch of the tax is of relative significance. To reach equity in fiscal treatment there should be a fixed allowance of each dependent whatever their number is. Taking the British experience in mind it should be desirable to differentiate between the various ages of the children as a child of 5 years does not require the relatively smaller part of his parents' income for his upkeep than a child of 20 and receiving a university education.[1] Generally speaking,

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(1) See Finance Act, 1958.

the family unit under the Egyptian income taxation does not receive the required attention in calculating the final liability and therefore the above mentioned recommendations have to be put forward after a careful study of the various family budgets which, as far as my knowledge permits, is under investigation at present.

(2) - Tax Relief for earned income

The discrimination between earned from unearned income by granting the former a special tax relief is a debatable point. In general, unearned income is derived from income-yielding property, interest, rent or monopoly gains. Earned income is usually derived from salaries, wages, any remuneration from an office or employment of an individual, professional or vocation gains, pensions, income from property forming part of the emoluments of any employment held by an individual, income from patent rights received by the inventor himself, or any other income derived substantially from labour. The difficulty arises in drawing the discriminating line between the two kinds of income. Sometimes individual incomes are mixed, partly earned and partly unearned. In order to distinguish between the different types of incomes, it is therefore necessary to state in advance the categories of taxable incomes, classified clearly into earned and unearned, in order to avoid the misapplication of the tax laws.

The advocates of granting tax relief to earned income base their doctrine on the argument that earned income is temporary and uncertain; sickness or death limits and destroys it, and also old age diminishes it, while unearned is permanent and lasts indefinitely.

The difference in duration between the two incomes gives no solid reason for discrimination. Unearned income, which is a permanent income, also pays taxes permanently as long as the sources last. If the income last forever, the tax will go on forever.

It could be emphasised that the differentiation might be based on the weight of the tax; the earner of a labour income has to save some considerable portion for future use of his wife and children. If this part is taxed when earned, it would be taxed for the second time when it reaches the beneficiaries. The holder of permanent income derived from property may indeed do the same thing and his savings may be subject to double taxation. This plea could be denounced on the grounds that most tax systems permit the deduction of life insurance premiums and sums put aside for old age pension from the taxable income. In this case, any relief given to earned income would be a violation of the equality principle. Another fact is that every property was partly created out of income derived from labour so any discrimination between earned and unearned income based on the source of income could be easily defeated.

The differentiation between earned and unearned income might be based on social grounds; that the property incomes stand for the leisure class - for those who contribute nothing directly to the community's resources but live on secure income-yielding possessions. Even though this justification for such differentiation is groundless, because interest and rent are as worthy and as defensible as any other sorts of income, any discrimination against them is unjustifiable.

Ultimately the justification for the discrimination between earned and unearned income lies on and was an invention of, the socialistic movement during the last century, and the increasing influence of the labour community upon the legislative and administrative authorities.

The Egyptian income taxes do not include explicitly any earned income relief, but it could be deduced from two major elements which construct the tax liability.

These two factors are: (a) the rate applied to the different Schedules under the Schedular Tax classified according to the source of taxable income and (b) the exempting limit and allowances granted to special classes according to the source of their income. An individual who derives his income from moveable property, i.e., interest, dividends; does not enjoy any sort of exemptions or reliefs, while that who derives his income from trade enjoys an exemption limit dependent on family status. On the other hand an individual who earns his income from work is entitled: (a) to a deduction of 7½% of his salary as a relief for retirement pension; (b) to a progressive rate starting from 2% on the first taxable of £E120 up to a maximum rate of 9% while it is 17% on income derived from commercial and industrial business; (c) and also to an exemption limit corresponding with the family status. Table 21 illustrates this phenomenon.

TABLE 21

Liability and Effective Rate under the Egyptian Schedule Tax[1]

(married couple with 3 children)

Income	Liability under Tax on Income from Moveable Property		Liability under Tax on Commercial and Industrial Profits		Liability under Tax on Wages and Salaries	
		Effect. Rate %		Effect. Rate %		Effect. Rate %
£E 100	£E 17.0	17	£E -	-	£E -	-
120	20.4	17	-	-	-	-
150	25.5	17	-		-	
170	28.9	17	3.4	2.0	.065	0.00
200	34.0	17	8.5	4.2	0.7	0.3
250	42.5	17	17.0	6.8	1.6	0.6
300	51.0	17	25.5	8.5	2.6	0.9
350	59.5	17	59.5	17	8.7	2.5
500	85.0	17	85.0	17	14.3	2.9
700	119.0	17	119.0	17	25.8	3.7
1800	170.0	17	170.0	17	39.5	4.0
1500	255.0	17	255.0	17	75.7	5.0
2000	340.0	17	340.0	17	117.6	5.9

(1) Tax on non-Commercial Professions not included.

Comparing the Egyptian income tax system applied within a less-developed economy, with the U.K., we find out that the latter system low-earned-income more lenient than the Egyptian system. Table 22 shows the effective rate and the starting point of tax liability under both systems. A conclusive fact could be drawn from such comparison; that is, when incomes are relatively low in Egypt yet the tax burden on low income earners is higher than the burden exercised by the corresponding income groups in the U.K. This is due mainly to personal reliefs expecially the 'earned income relief' granted to under the British income tax. Moreover, low income groups in Egypt bear a relatively heavier fiscal burden than their corresponding group in Britain. This is due to the regressiveness of the Egyptian fiscal system where indirect taxation amounts to over two-thirds of total tax revenue. On the other hand, while the U.K. income tax is highly progressive an income over £1,200 for example[1] the Egyptian tax rate on the same income is considerably low. This should be the other way around as an income of £1,000 a year is considered in Egypt, where the average income is low if compared to a developed country such as the U.K., a high income. Generally speaking earned income, especially within the low and middle income groups, receives a relatively harsh fiscal treatment under the Egyptian system if compared to that treatment received by either the corresponding income groups in Britain or if we compare it with higher income groups within the Egyptian economy. Therefore, two major adjustments have to take place to achieve equity; (a) increasing the progression of the tax on incomes over £1,000 a year and (b) granting an earned income relief for incomes below £1,000 a year, (a regressive relief).[2]

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(1) For a married man with three children, see Table 22.

(2) By a regressive relief it is meant that the relief decreases when income increases.

TABLE 22

Comparative Analysis of Liability and Effective Rate of Egyptian and U.K. Income Tax

"Income Earned from Employment"

INCOME	SINGLE				Married without CHILDREN				Married with 3 CHILDREN[1]			
	EGYPT		U.K.		EGYPT		U.K.		EGYPT		U.K.	
	Liability	Effect. Rate	Liability	Effect. Rate	Liability	Effect. Rate	Liability	Effect. Rate	Liability	Effect. Rate	Liability	Effect. Rate
		%		%		%		%		%		%
£E 100	£E -	-	£ -	-	£E -	-	£ -	-	£E -	-	£ -	-
150	1	0.6	-	-	0.6	0.4	-	-	-	-	-	-
200	2	1.0	2	1.0	1.6	0.8	-	-	1	0.5	-	-
250	6.3	2.5	6	2.4	6.3	2.5	-	-	2	0.8	-	-
300	7.8	2.6	14	4.6	7.8	2.6	-	-	3.3	1.1	-	-
400	11.8	2.9	33	8.2	11.8	2.9	9	2.2	11.8	2.9	-	-
500	15.8	3.2	55	11	15.8	3.2	28	5.6	15.8	3.2	-	-
600	20.8	3.5	81	13.5	20.8	3.5	47	7.8	20.8	3.5	-	-
700	25.8	3.7	111	16	25.8	3.7	74	10.6	25.8	3.7	-	-
800	30.8	3.9	145	18	30.8	3.9	102	12.7	30.8	3.9	11	2.4
900	37.8	4.2	178	19.6	37.8	4.2	135	15	37.8	4.2	29	3.2
1000	44.8	4.5	211	21.1	44.8	4.5	168	16.8	44.8	4.5	50	5
1200	70.1	5.9	277	23	66.1	5.6	234	19.5	58.8	4.9	105	8.7
1500	118.9	8.0	376	25	114.9	7.6	333	22.2	103	7.0	204	13.6
2000	204	10.2	542	27	199.5	10	498	24.9	186	9.3	370	18.5

N.B. (a) The U.K. tax liability is computed according to the Inland Revenue P.A.Y.E. Tables 1957/58 rates to the nearest £.

(b) Pension allowance and Superannuation allowance are not taken into account in computing the tax liability in U.K. and Egypt.

(1) Children under 11 years of age.

(3) - Personal Savings and Old Age Security

Life, health insurance and other contributions to funds set up to help the individual to maintain himself or his family in case of death or disability are usually admitted by tax legislations as reliefs deductible from taxable income.

Any contribution to any fund for the benefit of the taxpayer or his family is recognised as a type of personal saving which should be encouraged for social as well as economic reasons.[1] Savings in the shape of life insurance policies for instance represent an important part of national savings, in many countries which is essential for economic growth and stability. Other personal savings through national savings banks or post office savings branches also represent a sizeable part of the aggregate domestic savings. In less-developed countries governments should by all possible means encourage personal savings through fiscal measures. Tax exemptions are one of the most important measures .

On the other hand the present loss of tax revenue due to reliefs given to personal savings is usually compensated through the relative decrease in the overall social welfare expenditure as individuals (the private sector) provide a sort of special safeguard for old age and unemployment or disability which otherwise the government have to undertake. In other words individuals through private institutions do simplify and reduce the burden of the Government in providing social help for its needy citizens.

Now we are faced with the drawing of a list comprising what type of personal savings should be relieved and what are the limits of such relief. Here we are faced with the equity problem. Any relief has to be limited in its scope and therefore such limitation might produce inequity. The consideration of any

(1) "Royal Commission on the Taxation of Profits and Income", Final Report, June 1955, Cmd. 9474, pp. 18-24

idealistic policy for the encouragement of personal savings in an underdeveloped country has to be guided by the weight the government puts on economic development as against equity in fiscal matters. Generally, equity is overstepped during the phase of development in order to give way for economic progress and therefore the government policy mainly is directed towards the encouragement of savings, personal and business, without major significance is given to equity principle. But care should be taken in order to prevent any major tax evasion which might affect considerably the over-all tax structure and render the fiscal relief system unbeneficial.

Egypt grants complete relief for interest paid to individuals on their savings in Post Office Savings Banks[1] and on their contributions to a pension or superannuation scheme. Moreover, superannuation and any funds accumulated for old age security invested are exempted from income taxes on their net return. Subscriptions for life annuities and other life insurance premiums are deducted from income subject to the General Income Tax. No limit for such subscriptions is provided in the legislation and hence a loophole in the law has to be filled in order to prevent tax evasion and hence produce inequity in the distribution of the tax burden. In the fixation of the limit deductible we have to take into consideration the following factors: (a) the family responsibility of the taxpayer, (b) if he does contribute indirectly to other social security schemes and (c) the encouragement of personal savings in general through fiscal measures.

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(1) Deposits in Post Office Savings Banks amounted to £E 39.4 m. at the end of May 1958; it was £E 32.6 m. in 31.12.56. Deposits in Pensions and Insurance Funds for the Civil Servants was £E 20.7 m. at the end of January 1957 and reached £E 32.8 m. at the end of May 1958. Cf. Budget Report 1958/59, U.A.R., Egyptian Region.

- B - Economic Motives

Tax reliefs are usually devised to achieve economic objectives, mainly to encourage and promote economic developement by stimulating capital investment, domestic and foreign. Tax Policy is an important tool for stimulating private savings and investments and mobilizing idle resources. So exemption from income taxation are required to back up the investments of productive entrepreneurs. The analysis will be focused on the various important fiscal stimulants for capital investment within the scope of income taxation in a less-developed economy; Egypt is the case study.

(1) Exemptions of the public debt.

Most nations use public borrowing as a supplementary expedient governmental financing. Different fiscal purposes are often presented to justify the government's action in raising funds by borrowing such as to finance emergency conditions or irregular expenditure i.e. wars, floods and other disasters, to finance capital construction projects; to meet unexpected deficit in current revenues, and to finance existing debt. The most important object of governmental internal borrowing is to achieve and maintain full use of the nation's productive capacity.

Most of governments have used and still use some privileges attached to debt issues to attract and approach possible markets which would otherwise be closed to them. The major privileges associated with government bond ownership have been tax exemption. The tax exemption of the interest on a bond may be applied to all taxes, but various nations exempt the transfer of bonds through inheritance from death duties. It is alleged that a holder of a tax exempt bond will be willing to pay more for a tax exempt bond, through accepting a lower yield, than for a taxable one.

It is well understood that the main object of issuing untaxable bonds is to provide an attractive market for the public debt, strengthen government credit, and allow an opportunity for borrowing at a lower rate of interest. On the other hand there are various disadvantages which, in general, invalidate the doctrine of the exemption of interest on governmental bonds:

(i) The loss of revenue: The argument arises whether the governments which issue tax exempt bonds gain more from tax exemption than they would lose by taxing these, or vice-versa. This debatable question depends mostly on the proposition that the market price of exempt bonds measured by their yield is determined by the purchasers who benefit from such an exemption. A millionaire will benefit more that the ordinary person from such an exemption as the first will avoid the high rates of tax levied on his large income; i.e. if person A has an income of £2,000 a year and person B has a yearly income of £100,000 the latter will be subject to the high rates of income tax which in some countries reaches 80% or more, while the first person is usually subject to the lower rate. On the whole, the individuals with high income benefit more than those of lower incomes.

Every government which intends to issue tax-exempt bonds has to compute the amount of taxes which will not be collected and compare it with other privileges the government will obtain out of the operation. These governments should take into account not only income tax collected, but also other taxes, such as estate and inheritance duties, gift taxes and local taxes. These privileges could be focussed on the following:- (a) the lower rate of interest payable by the government, and (b) the marketing facilities of the bonds.[1]

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(1) It was estimated by the Federal Treasury (U.S.A.) that tax exemption on the average, permits an interest rate reduction of approximately 0.375%: A. G. Buehler, ~~American~~ Public Finance, p. 649

Any fluctuation in the rates of taxes or of interest will affect the net gain or loss of the governments issuing tax-exempt securities, i.e. if tax rates rise, the net fiscal loss is increased, and if the interest rates decline, the net loss will increase.

(ii) Socio-Economic disadvantages:

(a) The tax exemption of public debt interest gives an unfair privilege to specific forms of investment. It places government bonds into a preferred class and it restrains the market for other bonds to a certain extent because it induces rich men to invest their capital, not employed in business, in the government exempt securities, whereas this capital should be invested in active economic operations. In general, tax exemption of interest on governmental securities lowers the interest rates at which governments can borrow, thereby taking an unfair advantage of private borrowers, and thus diverting capital from direct private investment to governments.

(b) This type of exemption creates gross inequality of tax burden. "It means the liberation of unearned incomes at the expense of the earned incomes".[1]

(c) In a progressive tax system, the wealthy individuals will avoid the tax by investing their wealth in tax exempted bonds and consequently the fiscal burden of the tax becomes heavier on the individuals with low incomes. Therefore social justice and fiscal equality will be distorted by the maldistribution of tax burden between the taxpayers.

Various countries nowadays tax the interest on public debt in the same degree as all categories of income subject to direct taxation. This argument arrives directly from the formal principal of equality before the law. In general, the

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(1) E.R. Seligman, Studies in Public Finance, New York, 1925, p. 146.

method of taxing interest on public debt is proper for countries that have a high credit system, while on the other hand, countries that do not inspire the same degree of credit could apply the method of exempting the interest on public debt from taxation.

Public borrowing in Egypt for economic development is a relatively new device used by the Government. The first developmental loan was floated in 1955 and immunity from taxation was granted to the bond holders in regard to the interest paid or the main capital debt value from death duties.[1] Over two-thirds of loans issued for economic development since 1955 has been covered by the banking institutions in Egypt, while a major part of the remaining one third was met by other institutions.[2] Private investors, however, did not contribute considerably towards these loans. Although the general outlook within a less-developed economy that individuals do prefer safe and secured investments rather than investing their limited savings in risky ventures, this fact does not help the governments much in floating a considerable amount of public debt for development or otherwise. This is mainly due to the unsound financial policy of the government or to the political situation in existence, or to both. Moreover, individual savings in a less-developed economy is relatively low, and therefore the capacity of the government to borrow from the public is limited. A recourse, therefore, has to be directed towards financial institutions and other economic organisations to cover the debt issued.

It has been the rule in Egypt since the 19th century that the public debt, its interest and origin, is immuned from all existing and future taxes. I believe

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(1) U.N., Economic Developments in the Middle East, 1956-57, p. 17. See also Table 7, p.14.
(2) U.N., op.cit., p. 14

however, that exemption of public debt from taxation was, and still is of some attractiveness to individuals, but for a long-run policy, exemption of the public debt in future would not stimulate public borrowing in a less-developed country like Egypt. This pessimistic way of thinking is founded on the fact that the present hazy and poorly-developed money and capital market do render the floatation of any public loan a difficult task for the Treasury. Unless well organised and thoroughly planned steps to develop the money market in Egypt during the first stages of economic development, public loans could prove to be inadequate to stimulate investment and henceforth tax exemptions would not facilitate the floating of government securities. Of more importance, however, for public borrowing is the willingness of the general public to invest in public securities. This requires among other things, confidence in the monetary policy which the government has to guarantee by maintaining the highest possible degree of monetary stability.

(2) <u>The Exemption of new enterprises from income taxation</u>.

Different countries, especially after the World War 11, granted various tax exemptions to individual or corporate enterprises to stimulate their efforts to increase productivity and to reconstruct the undermined economy. On the other hand undeveloped countries try to stimulate capital investment in industrial and agricultural enterprises in order to increase their national income. This stimulation was achieved by different ways and means; advanced credit system, sound and stable political conditions, and fiscal reliefs for newly established enterprises. Fiscal reliefs might be approached through; a) tax exemption of new businesses for a certain period; b) special allowance to be deducted before arriving at taxable income; c) the carry forward of losses; d) tax credit for foreign taxes; e) agreements to avoid double taxation; and f) tariff protection, or direct public bounties.

Here we are mainly concerned with the effectiveness of income tax exemptions granted to new investments. Basically the exemption of new enterprises from certain taxes is advocated on the grounds that the new enterprise has a minimum power to compete with already established industries. This plea is denounced on the basis that if any business, regardless of its size of capital or plant, produces no profit it would pay no income tax, as the capacity of the business to pay the tax is nil. The upholders of the equity doctrine oppose the exemption of new enterprises from specific taxes on the foundation of their traditional philosophy that all persons, individuals or companies, should be equally treated before the fiscal law.

Our task now is to explore into the effectiveness of income taxation on investment decisions in underdeveloped countries. This point has been previously discussed in Chapter V and we have reached the conclusion that income taxation has a minor effect on the incentive to invest.[1] But in order to investigate the impact of income tax exemptions on investment in less-developed economies, it seems desirable to discuss the role of the tax within the framework of the marginal efficiency of investment criteria.

No one can deny the effect of income taxes on business profits, but on the other hand investment decisions are largely controlled by the prospective profits which depend on the various economic and technical considerations other than income tax. The impact of business income taxes depends relatively on the possibility of shifting such taxes forward to consumers or backwards to factors of production. Therefore the impact of unshifted business income tax might have a positive effect on the financial capacity of existing firms and on the willingness of companies to finance

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(1) See page 187.

new investments. It might have also a direct effect on the incentive to invest as it may reduce the disposable profits and thus reduce the net return of capital invested. Under a shiftable business income tax, its effect on investment will be negligible if not neutral, as the tax incidence on profits will not reduce the net return of investment.[1] By and large, the situation mostly depends on the economic power the business enjoys in order to shift the tax.

Now we concentrate on the situation where the tax on business profits is unshiftable. Investment depends mainly on various and diversified factors.[2] The magnitude of these factors in a developed economy differs from that of an undeveloped one. Investment decisions are usually influenced by economic, technical and political factors. Interest rate was considered an important factor in computing the marginal efficiency of capital, but during the last two decades, since "the late 1930's there has been a general tendency to suppose that investment is relatively insensitive to the interest

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1. See a series of articles by G. Cohn; J. K. Butters and J. Lintner under the title "The Role of Corporate Taxation in the American Economy", published in the American Economic Review (Papers and Proceedings), May 1954, pp. 486-542. See also D. T. Smith, Effects of Taxation on Corporate Financial Policy, (Cambridge, Mass., 1952) Chapters 5, 6 & 7.

2. H. G. Aubrey, "Investment Decisions in Underdeveloped Countries", published in Capital Formation and Economic Growth, National Bureau of Economic Research, (Princeton, 1955) pp. 397-440.

4) The smallness of the market may keep the plant from reaching the economic optimum size.
5) Low state of information concerning profitability of similar industries, the size of the market, competitive situation ... etc.
6) The absence of social overhead capital.
7) The supply of highly skilled labour is limited, and by and large taking other factors in account, the total productivity is low.
8) Economic and political stability in underdeveloped countries is often in doubt. Economic stability usually suffers from cyclical fluctuation abroad and also from reasonable changes internally; this affects the size of the market and the price level.[1]

The above factors render investment in the industrial sector of the less-developed economy hazardous, and therefore a relatively high net return is demanded in order to undertake any investment decision especially in poineering industries. Generally speaking, the above factors raise considerably the percentage of risk-bearing in underdeveloped countries and consequently the investor has to ask for a higher net return for his capital.[2]

Profits tax reduced this net return, but it is difficult to assert that it is a major element affecting the net return. Conclusive evidence, especially in

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(1) H. Aubrey, op.cit., pp. 399-401

(2) It is the cost of risk and uncertainty rather than the cost of borrowing safe funds which dominates the investment decision, the return on safe funds which is but one element in the cost of funds to the investor. So in a highly unstable economy, such as in many underdeveloped countries, where the planning period is necessarily short, little faith can be placed in the effectiveness of monetary policy if it is made to hinge on the rate of interest as a cost factor. The rate of return on safe investment, i.e. interest rate, is subject to manipulation by monetary policy, but in uncertain economy it is no major factor in investment decision. The other component of the gross interest, i.e. the risk taking or risk premium, is of major importance in the real investment decisions but is largely independent of monetary policy.

rate."[1]

Many factors do affect capital investment in underdeveloped countries especially in risky, mostly long-term, ventures. These factors could be summerized in the following:

1) The lack of entrepeneurial initiative.[2]
2) Individuals prefer traditional activities to new ventures and since industry is considered new in less-developed countries the preference is usually towards investment in commerce, real estate and other unproductive investments.
3) Individuals prefer short term investment which is regarded as more secure and where risk-taking is the minimum relatively to long-term industrial investment.

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(1) J. S. Duesenberry, Business Cycles and Economic Growth, (New York, 1958) P. 49 It may be useful at this point to recall that the concept of interest rate is considered of minor importance as a cost factor and in computing the profitability of investment. The traditional school of thought was that a reduction in the rate of interest causes a rise of the rate of private investment becuase it raises the expected profitability of investment. TheKeynsian theory follows the same line. This view was changed later just before the Second World War when explanations of the marginal efficiency of capital were recasted. The following example illustrates the significance of the rate of interest and its sensitivity to profitability. Suppose a firm expects a yield of 10% on invested capital after taxes and interest charges before any investment could be undertaken. If the tax rate is 50% and the interest rate is 2%, the expected yield before the tax and interest must be 22%. If interest rate rises to 4%, the required yield before taxes and interest rises to 24% Therefore, a 100% increase in interest rate raises the required return by only 9%. The conclusion would be that even "if the elasticity of the marginal efficiency schedule (in terms of expected return before taxes) were substantial, investment would appear to be inelastic to interest rate." See, op.cit., p. 50 For explanation concerning the old view see, M. Kalecki, "The Ways of Full Employment" printed in The Economics of Full Employment, Six Studies in Applied Economics, Oxford University Institute of Statistics, 1944.

(2) H. G. Aubrey, op.cit; and another article titled "Industrial Investment Decisions"; a comparative analysis, "Journal of Economic History," Volume 15,1955 pp. 335-351

underdeveloped countries, is difficult to find regarding the effectiveness of the tax on investment. As the rate of profits tax in most underdeveloped countries is relatively low if compared with existing rates in highly industrialized countries, we could cautiously say that income tax although it affects the net return; i.e. profitability of investment, it is only one of various factors which affect investment decisions.

Another important point we have to investigate before condemning or appraising the idea of exempting new investments from income taxation. We have to evaluate the balance between the benefits gained; i.e. the effect of the exemption on the rate of increase in investment, and the loss of public revenue which might have a direct or indirect effect on other sectors of the economy through the increase in the rates of other taxes. Primarily, it is difficult to predict the net loss of revenue through the exemption of new investment and in the same time it is also difficult to forecast the net increase in aggregate investment as it is limited by many factors other than fiscal measures. Ultimately, the economist and the planner cannot forecast the net benefit taxation. Assume that the country adopted this measure; i.e. exempting new enterprises, and after a few years, say five, we were faced by the need to calculate and evaluate the net result of such measure. From the budgetary incidence view point we can calculate the loss of tax revenue through aggregating the net profits of the new firms which benefited from the exemption. But on the other hand we cannot measure or calculate the benefit gained by the economy through the increase in total investment. Any increase in aggregate investment is difficult to attribute to a specified factor. Many and diversified factors, as previously mentioned, affect investment, and taxation is one of these elements. Therefore, it seems difficult if not impossible to confine any increase, or even a fraction of such increase in investment to a single factor. As a consequence we find that the "pre-evaluation" or "post-evaluation" of the net gain of the exemption of new enterprises is a perplexed and intricated task. The final decision to adopt any fiscal measure of the present nature, i.e. exemption of new ventures from income taxes, would ultimately depend on, more or less, subjective factors.

In 1953 Egypt granted a tax concession to all new joint stock companies as well as partnerships limited by shares undertaking business considered to be necessary for the development of the country's economy.[1] This concession takes the shape of complete exemption from Schedular Taxes on business profits as well as on distributed dividends for a period of seven years from the establishment of the company. Existing companies of the same legal constitution as the above are exempted from Schedular Taxes on profits derived from that part of capital newly invested and also on dividends distributed belonging to the new capital addition. Moreover such companies are allowed to pay only half the business income tax on its undistributed profits. The main motive behind this concession is to attract capital formation in productive investment which will increase the level of the national income. Since 1953 several companies benefited from this fiscal measure.[2]

For the lack of data we are unable to prove empircally the effect of this tax concession on the Egyptian economy especially on increasing capital accumulation,

(1) Law No. 430 of 1953.

(2) Out of 73 applications submitted to the "Special Committee" concerned with the enquiry of the type of investment to be regarded as necessary for economic development, eleven new companies and only four existing companies were granted exemption from the Schedular Tax. Thirty-six companies were exempted from half the Schedular Tax on undistributed profits. This data is relatively old as it represents the situation at the end of June, 1956. No further data is available for the confidentiality of all information regarding the enforcement of Law No. 430 of 1953

but it seems therefore unavoidable job to attempt to analyse the impact of this fiscal measure on mainly hypothetical grounds.

It is convincingly helpful to regard the accumulation of productive capital as the core of the problem of development. Such accumulation need not necessarily be directed towards industrialization, although in most areas it is clear that the marginal efficiency of capital is much higher in the industrial sector of the economy than in others and that the optimal use of resources suggest directing investment into this channel.[1] This has been the major aim of the planning authorities in Egypt and hence they introduced several different measures, fiscal and otherwise, to reach this aim.

To form any general justification for exempting new enterprises in Egypt from the Schedular Taxes on profits, distributed and retained, we have to enquire into two main points; the loss of revenue through such measure, and the net result on economic development based on our choice pattern between this particular measure and other tax measures such as accelerated depreciation allowance, losses carried forward or direct public subsidies. The ultimate conclusive judgement will be left to the end of this section after discussing the other alternative tax measures which are usually devised to stimulate capital investment.

In general the loss of revenue through the enforcement of a wide tax exemption programme could be hypothetical. First, tax exempt firms do generate tax revenues, these arise indirectly out of the flow of wage income and other secondary streams. Second, the exemption in general extends not to more than

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(1) The same conclusion is reached from a consideration of the possible sources of capital funds which may be generated within the economy. Profits, interest, and rents generated in the agricultural and commercial sectors of underdeveloped economies notoriously find their way into conspicuous consumption, land speculation, and hoarding; very little is invested in directions which would raise domestic productivity and increase output.

seven years, and firms attracted by tax exemption will thus generate direct tax income at the end of the exemption period. Inevitably the question arises as to whether the other tax measures, accelerated depreciation, for example, do give the same result or a better one. Accelerated depreciation, as we are going to elaborate, is more or less a free-interest loan to new investments which will be paid back in latter years while a complete exemption from business taxation is a net revenue loss from the Treasury point of view. This is a premium for the accelerated depreciation from regarding its budgetary incidence overtime. Consequently it is apparent that there would be a loss of revenue in adopting a programme of tax exemption of new investments, if we believe that such new enterprises will be able to realize a sizeable amount of profits during the first few years of its operation. This leads us to the fact that in underdeveloped countries where low technical ability and less efficient entrepeneurialship exists the profitability of the pioneering industries is small if not negligible. And for such reason the Government intervenes to protect the infant industries by introducing protective custom duties or through guaranteeing a percentage return on paid up capital. The economic as well as the budgetary incidence of such subsidies and bounties are well known as they do have a positive effect in the short run at least.

By and large, private investment in Egypt has been declining since 1951 up to 1956 (the latest available data is for 1956); it was £E112m. in 1950, and declined gradually till it reached £E39m. in 1956.[1] Therefore, it is obvious that the tax exemption concession granted in 1953 did not have any effect on investment as there were other strong factors which impinged on private investment beyond the control or the influence of any fiscal measure.

(1) See Table 4, page 17.

(3) Allowance for Accelerated Depreciation:

Investment could be successfully stimulated by choosing a special depreciation pattern which reduces the cost of capital assets and provides an early recovery of capital through tax-saving, i.e. tax-free reserves. Investment planning under conditions of relative certainty is easily approached if capital early recovery is possible. This commonly takes the form of requiring that the capital asset pays for itself in a time period substantially shorter than its economic life. This is well known as a "pay-off" for investments.[1]

Investors who seek a protection against risk by an early return of capital, "accelerated depreciation" may be a decisive factor. Accelerated depreciation will reduce the amount of profits subject to tax during the "pay-off" period and increase the available funds for further expansion through internal finance. This avoids external finance if not available. The preference for internally generated funds is widely accepted by businesses, but it is likely to be felt most keenly by the small and rapidly growing business that finds recourse to the capital market difficult.[2]

Accelerated depreciation, on the other hand, helps in obtaining external finances if it is necessary. Most lenders seek repayment of loans made to finance assets and equipment purchases over a period shorter than their economic

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(1) Analysis of certain aspects of this topic is clearly elaborated in E. Cary Brown, "Business-Income Taxation and Investment Incentives," in Income, Employment and Public Policy: Essays in Honor of Alvin H. Hansen, pp. 300-16 Also see, Robert Eisner, "Accelerated Amortization, Growth and Net Profits," Quarterly Journal of Economics, November, 1952, pp. 533-44

(2) See Evsey D. Domar, "The Case of Accelerated Depreciation," The Quarterly Journal of Economics, Volume 67 (November 1953) pp. 493-519, reprinted in "Essays in the Theory of Economic Development", by the same author. Oxford U. Press, 1957, pp. 195-222

life and thus, accelerated depreciation permits a free of tax cash inflow for debt repayment. This provides an extra safeguard to the lender.

Two main factors effect the influence of accelerated depreciation.[1] First, is the tax rate; present and expected future tax rates on net profits. Assuming that other things being equal "the higher the tax rate the more the investor gains from accelerated depreciation."[2] Second, there should be enough taxable income in order that accelerated depreciation could be offset; or in other words, the enterprise should enjoy an adequate capacity to absorb deductions for accelerated depreciation. If the deduction depreciation allowances were not permitted due to the non-existence of business profits the firm would not enjoy the benefits of the granting accelerated depreciation. In this case a complementary devise has to be introduced in order to make the accelerated depreciation devise more effective to small or non-profitable firms; that is to provide for a loss offset, a carry-forward or backward of business profits. This resolution would result in averaging the taxable income after benefiting from the depreciation provision over a long period.

Consequently, accelerated depreciation for tax purposes encourages investment by increasing profitability and lessening risk. In underdeveloped countries this method seems promising and several countries have already adopted such fiscal measure to stimulate capital investment.[3]

In Egypt no attempt was made towards adopting any method which aims at an earlier recovery of invested capital in new assets and equipment through accelerated

(1) R. Goode, "Accelerated Depreciation Allowances as a Stimulus to Investment", Quarterly Journal of Economics, May 1955, pp. 191-220

(2) Ibid., pp.201-202

(3) A. Morag, "Income Tax Exemptions and Accelerated Depreciation," Public Finance, Volume XI, 1956, pp. 356-365

depreciation. As such a device seems more promising in a less-developed country like Egypt, my final judgement is left to the end of the discussion after analysing other fiscal; e.g. income tax, measures as alternative devices.

(4) Losses Offsets as a Stimulus to Investment:

A reward in the shape of profits is the expectation of any type of investment. Risk and uncertainity which are encountered in most investment decisions have to be secured and covered through fiscal measures.[1] Such measures are needed to encourage investment in risky ventures which is considered better, from aggregate productivity point of view, than conservative investment, such as investment in land, residential buildings and other assets regarded as less productive and contribute little towards economic development.

Generally speaking, interperiod offsetting of losses is primarily an instrument for promoting equity in income taxation. In the absence of carry-over provisions, a firm with alternating losses and profits pays a larger aggregate amount of income tax, over a period of years, than does a consistently profitable firm earning the same net income for the period.[2]

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(1) With respect to the allocation of investment funds as between risky and unrisky investments, an unlimited loss offset means that the tax penalty against risky investment is removed. The investor still has to choose from among investments with varying degrees of risk, but his choice appears no longer disturbed by government participation in his earnings. For limited period of loss offset, the impact upon risk-bearing depends upon the proportion of losses which can be absorbed. Generally, if the tax loan does not permit a complete offset of losses, there still exists a degree of discriminationagainst risky investment. See on this topic, article by R. Musgrave and E. Domar, "Proportional Income Taxation and Risk-Taking," Quarterly Journal of Economics, Volume LVIII, pp. 388-422

(2) Comparing firm A, which earns £500 in each of two successive years, with firm B, which loses £1,000 one year and makes £2,000 the next. The two firms realize the same net income over the same period; yet firm B will be liable for tax on twice as much as will its profitable rival unless tax laws permits B to carry its loss forward.

A progressive tax on profits has a different effect on losses offset than a proportional tax. Under the latter, losses deducted from taxable income neutralize the effect of taxation on the reward of risk-taking. This is true if the provision for carry over losses is unlimited.[1] But in the case of a progressive tax such an effect does not exist. The reward for risk-taking is usually reduced under a graduated tax if losses occur and the "tax saving from deducting a loss from taxable income is usually smaller than the tax liability would have been on a gain of equal size.[2]

By and large, carry forward of losses in particular encourages formation of new firms by diverting to the government part of the burden of initial losses. Similarly, carryforwards of business losses promote the expansion of existing firms into new lines of production. Unlike the carryback of losses method, the carryforward puts the new and the old firm on an equal footing. Whereas the carryback impedes the entry of new firms into a competitive industry, the carryforward assures the new investor of equal benefits under the tax law in case of early losses.[3] A choice between the two devices depends upon further considerations, among them the question of whether control of depression, using the carryback device is more important than the encouragement of new investments. Encouragement of capital investment is by all means the main aim of underdeveloped countries and therefore it seems more appropriate to adopt the carryforward device for an unlimited period.

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(1) For the illustration of this point see this example given by R. Goode, "The Corporation Income Tax,'New York, 1951, p. 120.

(2) Ibid., p. 121

(3) The superior ability of the carryback method to counteract depression must be weighed against the inferior quality of resource allocation which it produces. The carryforward is less useful as a countercyclical device.

The Egyptian Schedular Income Tax on Commercial and Industrial Profits does allow a three years carryforward of business losses. No provision is made for a complete carry over of losses to stimulate capital investment, and our final decision on the matter would be either to introduce such fiscal devices to attract investment or to adopt other alternative measures. This decision is the concluding part of this analysis.

(5) The Exemption of Business Savings:

The fiscal treatment of undistributed business profit depends mostly on economic conditions prevailing and on the need for revenue to meet public expenditure. The discrimination between distributed and undistributed profits in tax treatment was held feasible during business cycles as a measure to reach equilibrium.

The fiscal treatment of undistributed profits takes one of the following shapes: a) complete exemption from taxes: b) levying a reduced rate compared to that levied on distributed profits: c) equalizing in treatment between distributed and undistributed profits: or d) imposing a separate tax other than income tax.[1]

A complete or partial exemption of undistributed profits, which is our present concern, would, in normal environments, stimulate the accumulation of business savings and decrease the amount of distributed profits. Rich shareholders will benefit from such a policy as they will avoid the progressive rate of the income tax on their high income. Moreover their net worth is inclined to become enhanced

(1) In 1936 an "Undistributed Profits Tax" was introduced into the U.S.A. tax system. The rate of the Tax was progressive, ranging from 7% to 27% as a supplement to the "Corporation Income Tax". Business and popular reaction was generally unfavourable and this let to a repealment of the tax in 1939. See W. J. Shultz and C.L. Harris, American Public Finance, p. 443.

by the increased value of their shares. Furthermore if the tax system exempts capital gains the investor will be encouraged more not to cash any dividends and stimulate the undistribution of profits, and therefore he could easily realize capital gain through the sale of his stock which is appreciated in value due to the accumulated profits.[1]

By and large the major argument which encounters the discrimatory fiscal treatment in favour of undistributed profits is usually concerned with the rationality of the business to reinvest these retained profits compared to the rationality of the individual shareholder if such business savings were distributed. In other words, what is the greatest benefit gained by the community as a whole from the viewpoint of economic development by adopting a discrimatory tax policy?

In underdeveloped countries many governments attempted to stimulate capital investment through exempting, partially or completely, undistributed corporate profits. Egypt provided a tax concession, the application of half the income tax rate on undistributed profits within the Law No. 430 of 1953 which was introduced to encourage capital investment for economic development. Shareholders in most less-developed countries are usually from the high-income groups and the distribution of dividends, therefore, would result in an increase in their amount of savings and thus investment. While this abstract judgement might prove to include a great deal of truth, it has, on the other hand been argued that such dividends received by high-income groups would find its way towards either consumption attracted by the 'demonstration effect' or towards unproductive investment, such as in buildings, land or precious metals.[2] In Egypt the authorities have a rigid control over the

(1) For arguments on this topic see, Royal Commission on the Taxation of Profits and Income, Final Report, 1955, Cmd. 9474, pp. 155-160

(2) However, in U.S.A. and Britain, historically self-financing has played an important part in capital formation; it was estimated that self-financing contributed nearly three-quarters of U.S. capital formation even in 1923-29, when capital markets were also very active. CF., G. Aubrey, op.cit., p. 429

construction of new buildings through licencing, and the limitation of the ownership of agricultural land through the Land Reform Law of 1952; 200 acres as a maximum of land tenure. Although these effective measures were adopted there might exist a great tendency towards expending such dividends on conspicuous consumption and thus diverting a significant source of the nation's resources towards unproductive goals. On the other hand if businesses were encouraged to retain a sizeable part of their profits through the exemption of undistributed profits, such retained profits might be directed towards investments which are of less benefit to economic development. This problem has been solved by the Egyptian legislator as he limited the application of this fiscal privilege, i.e. the exemption of undistributed profits from half the income tax, to companies which are engaged in economic activities highly significant for economic development.[1] Therefore, retained profits, however, could be reinvested more benefitially in underdeveloped countries than if it was distributed.

Finally, during the phase of economic development inflationary tendencies are widely experienced in less-developed countries.[2]

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(1) A ministerial Committee is formed from various government experts to study each application submitted to benefit from such provision; and upon the decision of this Committee depends the granting of such fiscal privilege. See Article 6 of Law No. 430 of 1953.

(2) R. Goode, "Special Tax measures to Restrain Investment", Staff Papers (I.M.F.) 1957, pp.

Adopting a fiscal policy of discriminating in favour of undistributed profits, inflationary pressure could be partially defeated.[1]

(6) Direct Public Subsidies:

The various previously discussed tax measures are considered as indirect public subsidies to special types of investment. Direct subsidies on the other hand take a straight and outright aid to investment either through paying off losses or guaranteeing a minimum return for each share of equity capital. Direct subsidies could be prescribed as an alternative to tax exemption. Although subsidies might appear feasible and effective yet it is most difficult to devise a direct subsidy which provides an incentive for efficient operation. Subsidies designed to underwrite initial losses, for instance, will encourage a failure to eliminate these losses, and will tend to become permanent. The government incentive to

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(1) The effect of a fiscal policy discriminating in favour of undistributed profits on economic stability is a controversial issue. The exemption of undistributed profits from income taxes during inflationary periods has been adopted by several countries during World War II so as to stimulate business not distribute large amounts of their profit and thus decrease the purchasing power and consequently mitigate the inflation. On the other hand, such policy was opposed on the grounds that if profits were undistributed it would be used to finance internally further expansion and would not reduce the inflationary trend as expected through the increasing demand on capital goods which, according to the multiplier effect, would increase the propensity to consume. This argument is not completely valid even if it tends to include some truth, but it is difficult to measure its effect on the economy; which of the direct impact of exempting undistributed profits from taxation on the business cycle is nearer to our touch through its effect on the consumption function. See, R. S. Williams, "Fiscal Policy and Propensity to Consume" The Economic Journal, 1945. Government control through legislative measures, in times of inflation, could bring a sound and practical compromise. It could prohibit the use of accumulated savings for further expansion unless official consent is granted. This measure was adopted by the Swedish Government just after the World War II See article by J. P. Shelton and G. Ohlin, "A Swedish Provision for Stabilizing Business Investment," American Economic Review, 1952, pp. 375-380.

subsidise tends to grow with failure in business, for fear of losing subsidies already invested. Therefore, in this case subsidies tend to encourage unstable temporary and fugitive industries. Any programme of subsidies would be far more susceptible to errors of judgement and to corruption, than other types of fiscal devices designed to encourage capital formation.

What is The Appropriate and Effective Measure for an Underdeveloped Economy? A concluding attempt at synthesis:

Any fiscal programme must be judged not according to the abstract principle but according to their developmental effects. A loss of revenue even if it were real and not largely fictitious, would have to be measured in terms of a comparison of present costs to future benefits. Likewise, the use of other abstract ideas such as 'equity', are void of significance unless they refer to a specific situation. Any tax might be condemned outright as inherently unequitable and discriminatory.. All that can be hoped for, in the wide sense of the equity principle, is that a tax law will give equal treatment to similarly situated taxpayers, and that its differential impacts between classes of taxpayers will correspond with the goals and the intentions of public policy. With regard to the first criterion income tax exemptions granted to industrial and commercial enterprises in Egypt (Law No. 430 of 1953) do give equal treatment to similarly situated firms. Such a situation could be advocated on the grounds that it is needed to enforce public policy.

However, inevitably the question arises as to whether tax exemption of new investments is an efficient use of such powers, or whether alternative better measures could be devised. Accelerated depreciation accompanied by a carryforward of losses for unlimited period seems to be most desirable in underdeveloped countries for stimulating capital investment. The reasons for this explicit justification have been implicitly discussed previously when discussing the various measures, but it would be of great help to sum them up:

1) Accelerated depreciation speeds up the amortization of capital invested especially if we take into consideration that interest rate are ordinarily high and that capital is scarce in underdeveloped countries and therefore permits greater reliance on internal financing.

2) Accelerated depreciation is considered, more or less, a tax-free loan to new assets which will be repaid after the end of the full amortization of the new asset, it is usually five years for new plants. Only small loss of revenue therefore is encountered.

3) Accelerated depreciation offers a much greater incentive to a growing enterprise than to a mature or a declining one. For a declining enterprise accelerated depreciation offers only a temporary deferment of tax payment. For a growing enterprise it is a permanent one.[1]

4) Accelerated depreciation is most attractive to capital-intensive industries in which the ratio of depreciable assets to total investment is high.

5) Accelerated depreciation could be efficiently administered if compared with a programme of direct subsidies for example. The former is much less apt to corruption than the latter especially in less-developed countries where administration is inclined to be inefficient and partly corrupted.

6) A provision for unlimited carryforward of losses renders the accelerated depreciation allowance an effective method in attracting capital investment. Such combination helps to average total profits over time and hence equity could be more adequately achieved.

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(1) CF. E.D. Domar, "The Case for Accelerated Depreciation", Quarterly Journal of Economics, 1953, pp. 493-519; and also see, E. Cary Brown, "Business-Income Taxation and Investment Incentives", in: Income, Employment and Public Policy; Essays in Honor of Alvin H. Hansen, (New York, 1948) pp. 300-316

7) All types of investment, new or old, will benefit from accelerated depreciation allowance but the amount of benefit will be related to the amount of investment, rather than the size of profits as under a full tax exemption.

Chapter VII

The Role of Exemptions in the System (Continued)

II. The Problem of Double Taxation

The problem of double taxation has attracted a great deal of discussion by several economists since Adam Smith. However, the double taxation dilemma became more acute when countries became more interdependent especially with regard trade and commerce. Domestic double taxation has also been the subject of various discussions regarding the overlapping of local jurisdictions with the central, and also the problems arising from the taxation of savings, etc., twice or more by the same tax.

The discussion of the problem of double taxation in this chapter is an attempt to analyse the various causes and remedies of double taxation from the theoretical viewpoint and also from their application to the Egyptian income tax system.

The first section is devoted to the domestic double taxation problem; i.e. the taxation of income twice or more by the same authority or by several domestic authorities. The discussion will be focussed on the theoretical analyses of the problem and the situation within the Egyptian income tax. An attempt to be made to elaborate the basic handicaps and to analyse solutions adopted in solving the problem.

The second section deals with the problem of double taxation from the international side. International double taxation has been considered as the leading example of a tax barrier to foreign trade and investment. The removal of international double taxation has traditionally been the first aim of those who sought to promote the expansion of international trade and investment through tax measures. The problem of international double taxation extends to many tax categories, property taxes, estate duties, etc., but it is most strongly felt by foreign investors and traders in the field of income taxation. Therefore our discussion will be limited to international double taxation of income; its causes and remedies. The Egyptian experience in this field is very limited and the important steps towards the use of international tax agreements have been taken only during the last five years when the major policy of the Government was directed towards encouraging investment and using fiscal measures to reach this aim. As the Egyptian experience is limited in this field our analysis will be basically confined to the main problem and the various devices which could be used to solve it. However, foreign private investment in Egypt is still in a very elementary stage and a pressing need for international tax agreements may arise in due course. We have, therefore, to compare the most effective devices for the prevention of international double taxation of income and try to find the most suitable device without causing undue inequity or loss of revenue. Finally, we have to bear in mind that the basic reason for international tax agreements is to prevent multiple taxation of the same income. Hence, we have to consider these agreements as a safety valve and to assure that the same income is only taxed once by the legitimate jurisdiction.

(A) Domestic Double Taxation

Double or multiple taxation in its broad sense occurs when the same income is subject to more than one tax. Multiple taxation may be either intentional or unintentional. The former is mostly due to a certain legal confusion which is taken into consideration by the legislator, i.e. imposing central as well as local taxes on property; the latter results from using more than one concept in assessing taxable incomes.[1] Generally such intended multiple taxation bears little or even no unequitable burden as the legislator takes into account the total amount of taxes paid by the taxpayer. On the other hand the unintentional double taxation raises the most unequitable distribution of tax burden between the taxpayers. In most cases such multiple taxation is due to the rigid and the conflicting jurisdictions adopted by the various countries especially when the question of taxable income arises.

Our discussion in the course of this section will be concentrated upon the domestic double taxation which arises by taxing the same income by different authorities within the nation, or by the same jurisdiction or authority more than once.

Double Taxation due to the distribution of legislative Power between Central and Local Authorities:

The central Government is the principal authority in levying taxes. But

(1) It is desirable to clarify that the imposition of a schedular tax and then a general tax is not multiple taxation because the latter import is a sort of surtax. Multiplicity does not occur if all incomes were taxed twice at comparable rates or if the income tax is supplemented by an 'excess profits tax', because these are cases of merely high tax. See P.E. Taylor, The Economics of Public Finance, p. 432.

decentralisation of power controlling the various provinces of the nation had developed and each province claimed its independence from the central government in fiscal matters. Revenues were needed to meet the ever increasing expenses of the local authority and therefore, imposts had to be levied upon property located within the boundary of the province and later on income of its inhabitants.

The problem of multiple taxation within the same nation causes great hardships for trade and commerce in a federal country and its rigorous consequences in the interstate relations. In the U.S.A. the problem of multiple taxation has been partially solved by the Court decisions and the complete solution of this problem remains in the hands of time. This problem of conflicting taxation is of interest to governments because the competition and duplication of taxation affect the availability of tax revenues. The problem is also important to taxpayers who have to endure unequal and unjust taxation because of the struggle of rival governments for revenue. To solve the issue that arises from conflicting taxation, the reforms undertaken should ensure adequate revenues to all governments and should bring to taxpayers the maximum of equality and uniformity of taxation.

Co-ordination in the fiscal policy, especially in imposing taxes, should be the major aim in order to reach a fair and just solution of multiple taxation in a federal country, as the independence of state and local governments is the most powerful feature which sometimes rules out the federal government policy. Therefore, a co-ordinated fiscal policy, a uniform method of assessing state income taxes, is needed in order to avoid duplicate taxation and to overcome inequalities in taxation among states and other local governments. An important fact has to be mentioned; it is that, in a federal country, since federal, state and local governments must be supported by taxes on the wealth and incomes of the people, some duplication is inevitable, unless there is to be rigid observance of a scheme of segregated revenue sources for the respective jurisdictions.

The situation in Egypt differs as it is non-federal country. The local authorities enjoy a semi-independent fiscal policy. The overlapping of judicial power is very limited and the local bodies are authorised to tax on a limited scale so as not to encroach upon the central government taxation structure. Therefore, it could be said that such limitation is a ceiling in relation to income above which local taxes cannot rise without economic disloction resulting.

In an advanced country such as Britain local taxation is mainly rates imposed on persons occupying land and buildings.[1] As rates are the only levies permitted to local authorities in Britain, multiple taxation between central and local jurisdictions is reduced to a great extent. It is a well known fact that the British local rates are of a regressive feature which changes the progressive structure of the national tax system.[2] Therefore, the over-all tax system can thus be made less progressive for some or all income groups, and inequality in the distribution of the fiscal burden results. The following table illustrates the regression of rates in the low-income groups and its affect on the distribution of aggregate percentage of both, rates and direct taxes.

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(1) Rates in Scotland are levied on both owners and occupiers and usually shared equally between them.

(2) U.K. Hicks, Public Finance, pp. 239-244, and H. Dalton, Principles of Public Finance, pp. 43-44.

TABLE 23

Regression of Rates, and Rates Plus Direct Taxes
In the Low-Income Groups, 1951-52.

Gross Household Income	Per cent. of Gross Income		
	Rates	Direct Taxes	Rates & Direct Taxes
£	%	%	%
Under £100	10.4	0.1	10.5
100-199	6.8	1.8	8.6
200-299	4.2	4.8	9.0
300-399	3.3	5.4	8.7
400-499	2.8	5.9	8.7
500-599	2.4	7.0	9.4
600-699	2.3	8.2	10.5
700-799	2.3	10.0	12.3
800-899	2.2	12.0	14.2
900-999	1.9	12.8	14.7
1000-1499	1.9	16.1	18.0
1500-1999	1.5	23.2	24.7
2000 and over	1.0	45.2	46.2
	2.4	13.6	16.0

N.B. Sample of 1899 households

Source; Lydell, H.F. and Dawson, R.F.F., "Household Income, Rent and Rates", Bulletin of Exford University Institute of Statistics, Oxford, 1954, p. 111.

One can abstract from the above table that the local rates have weakened the progression of the direct taxes which are mostly composed of the Income tax. The first attracting observation is that the local rates have a considerable affect on the lower-income groups, from under £100 up to £299 which should be the other way around and bear relatively low tax burden in realising their social necessities and the subsistence standard of living they enjoy. To put it in other words, the British local rates do in fact disturb the scale of progression of the Income Tax and distort the distribution of the over-all tax burden in unequitable condition especially within the very low-income groups of taxpayers. But to leave such a statement as it stands is not completely true. We must take into consideration the effect of 1) other taxes, other than income tax and local rates, such as purchase tax, excise and customs as well as inheritance duties, on the over-all tax burden on the majority of the British population; 2) the social services rendered by both central and local governments. In considering these factors we have to deal with the relationship between the general tax burden, which in turn is related to the taxable capacity of the nation, and the problem of national double taxation under discussion.

Double taxation within the same country and due to the overlapping of jurisdictions depends on the ways and means by which the different taxes, direct and indirect, are distributed among the taxpayers and also their final incidence. Moreover, the impact of all types of taxes on the different sources of income subjected to such taxes should be considered. The major object is to discover the relative impact on each taxpayer enjoying the same income and in the same civic status, supplemented with the intention to reveal the direct impact of the various taxes on various sources of income, i.e. income from property, income from trade and commerce, income from mere labour employment and others. In case that the overlapping of central and local tax jurisdictions, in a unitary country, does not distort the corresponding relation between taxpayers deriving their income from the same source and enjoying the same family status, such overlapping could not justifiably be reckoned as double taxation, but it could be cautiously emphasised as an increase in the tax rate or an increase in the over-all tax burden. Although double taxation in its concise sense does increase the over-all tax burden yet a well studied local impost could lead to an equitable and non-distortion of the over-all tax burden on the various taxpayer groups. Thereafter, the question of taxable capacity could be easily raised as it is closely related to the distribution of the tax burden. This question is a matter of the general socio-economic policy of the central government which does not contradict with a justifiable and equitable local levy.

The Egyptian situation has had several changes regarding the fiscal structure of the local authorities. Before 1939 when the first Income Tax Act came into effect, the law allowed an additional rate ranging from 8% to 11% on the existing taxes. The only functioning taxes during the 1930s period were those on land and houses. Later on Provincial Councils extended the additional taxes to the newly imposed Schedular Income Taxes. The Municipality of Alexandria for example levied a rate of 2.5% on the amount of the tax on commercial and industrial profits and on the tax on moveable property. Taxes on property is the central government levy but the Provincial Councils have the authority to levy an extra rate on such taxes with a minimum limit.

The fiscal policy of the Egyptian Local Authorities was criticised from the following points; a) the constitutional right of these authorities to levy such taxes, and b) the direct and indirect impact of such levies on the location of industries and other business concerns. The Parliament admitted the constitutional right of the Local Authorities to levy such extra rates.[1] The Chambers of Commerce criticised such imposts condemning them as being unequitable, penalising the companies whose head offices were in the jurisdiction of certain municipalities and threatening the dislocation of the administrative domicile of business.[2]

In 1950 Law No. 155 came into effect imposing an over-all excess tax of 10% above the Schedular Income Tax on commercial and industrial profits for the benefit of the Local Authorities except the municipality of Alexandria which was allowed to retain its excess taxes. The Municipality of Alexandria and that of Cairo have special category in relation to other Local Authorities. They enjoy a fiscal privilege over other municipalities as they are allowed by law to levy an extra rate of 10% on the Schedular Income Tax on moveable property which is not allowed to other Local Authorities. Moreover, Alexandria Municipality is allowed to impose an extra 5% on the Death Duties.

Besides the additional taxes levied for the benefit of Local Authorities a Defence additional Tax was imposed in July 1956 levying an additional tax on the various incomes subject to the Schedular Income Tax, the General Income Tax and on all types of property subject to Land and Building Taxes.[3] The rates of this tax vary according to type of income: 1) 3.5% on net income subject to tax on moveable property, tax on commercial and industrial profits and tax on non-commercial professions; 2) 1% on the first £E500, 2% over £E500 of income subject to the

(1) Official Journal, Parliamentary Ed. No. 24, 1944.

(2) The Journal of the British Chamber of Commerce of Egypt, May 1943, p. 65.

(3) Law No. 277 of 1956

Schedular Tax on wages and salaries; 3) progressive rate starting with 2% of the first £E2500 subject to the General Income Tax, 3% on the following som of £E1500, 5% on the next £E10000, 7% on the following £E15000 and 10% on higher brackets.

From the above review we can abstract the obvious unequity resulting from the difference imposts levied by the various Local Authorities in Egypt. A shareholder living in a city other than Cairo or Alexandria enjoys a special privilege compared to that shareholder living in those cities. Such clear unequal fiscal treatment of taxpayers could result in the dislocation of industry as well as in considerable income tax evasion especially the extra rate levied for the benefit of the Local Authorities.

The following tables illustrate the distortion in the final distribution of the different taxes on income as a result of levying the additional rate for the Local Authorities and the additional tax for defence. The tables show the difference in the aggregate tax liability between taxpayers living in Cairo or Alexandria and taxpayers who live in other parts of the country. The net income subject to tax is £E500.

TABLE 24

The Central and Local Tax Liability on Net Income of £E500

	Income from Movable Property		Income from Comm.[x] and Industrial Business		Income from Wages and Salaries		Income from[x] Non-commercial Professions	
	Cairo or Alex.	Other Areas	Cairo or Alex.	Other Areas	Cairo or Alex.	Other Areas	Cairo or Alex.	Other Areas
	£E	£E	£E	£E	£E	£E	£E	£E
Schedular Income Tax	85	85	85	85	15.8	15.8	55	55
Local Add. Tax	8.5	-	8.5	8.5	-	-	-	-
Total	93.5	85	93.5	93.5	15.8	15.8	55	55
Defence Add. Tax	17.5	17.5	17.5	17.5	5	5	17.5	17.5
Aggregate	111	102.5	111	111	20.8	20.8	72.5	72.5

x Before the latest amendment of December 1955

TABLE 25

The Direct Impact of Central and Local Taxes on Net Income of £E500

	Income from Movable Property		Income from Comm. and Industrial Business		Income from Wages and Salaries		Income from Non-commercial Professions	
	Cairo or Alex.	Other Areas	Cairo or Alex.	Other Areas	Cairo or Alex.	Other Areas	Cairo or Alex.	Other Areas
	%	%	%	%	%	%	%	%
Schedular Income Tax	17	17	17	17	3.16	3.16	11	11
Local Add. Tax	1.7	-	1.7	1.7	-	-	-	-
Total	18.7	17	18.7	18.7	3.16	3.16	11	11
Defence Add. Tax	3.5	3.5	3.5	3.5	1.0	1.0	3.5	3.5
Aggregate	22.2	20.5	22.2	22.2	4.16	4.16	14.5	14.5

Table 25 shows the distortion caused by the levying of local taxes on the Schedular Income Taxes especially in the case of the additional rate levied on income tax on 'movable property' for the benefit of Cairo and Alexandria municipalities only. This discrimination amounts to 1.8% on net income which could have, in the long run, a positive affect on the location of business.

The general comprehensive result of multiple taxation of the same income by either the same jurisdiction or by several in Egypt should be judged on the equitable distribution of the tax burden before and after the levying of the additional taxes. Suppose that the total burden of taxes on income, central and local, is 100, therefore according to Table 24 a person living in Cairo and deriving his income only from moveable property, i.e. securities compared with another person living in Cairo too and enjoys the same amount of income from his salary are nearly in the same situation before and after the levying the additional taxes, e.g. the relationship is 84.3 to 15.7 before levying additional taxes, and 84.2 to 15.8 after levying additional taxes.

Consequently the Egyptian case of multiple taxation is only a rise in the rate of the Schedular Income Tax without serious alteration to the ultimate tax burden. While the mere drawback is the various legislations which differentiate between the municipalities and, as is mentioned above, could result in tax evasion and in the migration of business where local levies are considerably low.

Double Taxation of Business Savings:

Savings, according to the classical school, should be immune from taxation in order to achieve equity in distributing the tax burden. The problem of the double taxation of business savings and their exemption has been discussed from the theoretical point of view in the previous chapter.[1] The following is the practical analysis of the way in which the problem of savings and undistributed corporate profits is tackled under the Egyptian income taxes.

Multiple taxation within the frame of direct taxes on income in Egypt is partially controlled by legislation. Corporate profits are subject to the Schedular Tax on Commercial and Industrial Profits but exemption is granted to that part which is distributed, as the latter profits, i.e. dividends, are subject

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(1) See page 241

to the Schedular Tax on moveable property. Various complications arise in the course of applying these provisions which sometimes result in double taxation of the same income. For example, if a corporation retains part of its profits as reserves in one year, it has to pay the 'Schedular Tax on Commercial and Industrial Profits'. Later it might decide to distribute part of these reserves in the shape of dividends or free shares, and they would then become subject to the Schedular Tax on Moveable Property.[1] Thus these distributed profits are in fact taxed twice, once as undistributed income and then as distributed dividends. According to the present rate of the Schedular Taxes on either Commercial and Industrial Profits or on Moveable Property is 17%, and hence, in our example, such dividends would be subject to a rate of 34%

The solution for the double taxation problem in the above example is relatively difficult to attain. From the accountancy point of view the undistributed profits may be added to the reserve account or might be invested in securities or reinvested in the company through the purchase of tangible or intangible assets. Therefore, it is considerably uneasy a task to trace the undistributed profits' position in a company's accounts and consequently if the company decides to distribute an account in excess of any year's realised profits, it is, in most times, difficult to follow the real course of such excess distribution and its year of origin. From the fiscal view point, the tax rates might change from one year to the other. Thus

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(1) Article 1. Law No. 14 of 1939 provides that "... a tax, at rates herein stated shall be levied on the income derived from negotiable securities. The tax shall be levied on: 1) Dividends, interest, arears and other profits derived from all sorts of shares, including founders shares, in all sorts of financial, industrial or commercial companies and general enterprises, whether such profits are periodical or not and whether distribution is effected in money or granted in the form of shares, debentures ..... or in any other form even indirectly."

any adoption of granting credit against the already paid taxes on the excess distribution will be an unsound solution in view of equity as all accumulated undistributed profits have paid income taxes at different rates. Therefore, any credit given against the taxes paid will bear heavy on some profits and light on others.

The only solution to the above problem, which I believe is still relatively inadequate from the view point of equity, is to adopt an average system in the course of applying the credit method. Such a method has to be carefully studied in relation with the overall fiscal policy of the country which in turn depends upon the economic circumstances in a specific period and the future socio-economic plans of the country.[1]

Other Cases of Double Taxation within the Egyptian Income Taxes:

The Egyptian taxes on income, especially the Schedular Income Tax which came into power in 1939, provide for the avoidance of double and multiple taxation whenever it is possible and legally adequate. The following cases are the most important in the structure of Egyptian Income Taxes which will be discussed from the equity view point and the adequacy of the present provisions adopted to avoid double taxation of the same income.

1) Business profits of an enterprise might contain different elements of revenue other than business profits; such as income of investments in securities, in immovable property, i.e. houses or land or other types of indirect investments

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(1) The fiscal policy of an underdeveloped country as in Egypt depends on encouraging investment in either already functioning enterprises or in new ones. Therefore I believe that it is adequate to discourage any redistribution of undistributed profits by taxation and even more, to encourage the reinvesting of profits by granting a tax relief, in a shape of reduced rate to undistributed corporation profits. This policy will achieve two basic objectives, overcoming inflation and encouraging investment.

which might not be the principal object of the enterprise. Such revenue is subject to either the Schedular Income Tax or the Taxes on Property. Therefore, if the income derived from these investments is added to the net business profits and the aggregate becomes liable to the Tax on Commercial and Industrial Profits, the subsidiary income is deemed to be taxed twice. The Egyptian law provided an exemption of 90% of any indirect revenue which accrues to any enterprise in assessing the business tax liability.[1] A fixed rate of 10% of the revenue has to be added to the net business profits to pay for the expenses of the management of such property. The fixed proportion, 10%, is somewhat arbitrary and it should be in progression of the indirect revenue and depend on the type of property owned by the enterprise as, for instance, the management of immovable property is quite different from that of securities or other immovable property; the first is inclined to cost a considerable amount of expense and also time of the firm's employees than in the case of immovable property. Consequently according to the present situation a business investing part of its capital in moveable property such as buildings or land is in a relatively better standing from the equity point of view than a firm investing part of its capital in securities.

2) Banks, central or commercial, and any enterprise dealing with issuing credit are granted a relief from Income Tax on the interest due on debts or deposits in so far as proof is established that such interest is included in the accounts of the enterprises situated in Egypt which are subject to the Tax on Commercial and Industrial Profits.[2]

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(1) Article 36 of Law 14 of 1939.

(2) Article 15 of Law 14 of 1939 which levies a tax at a rate of 17% on interest on all privileged mortgages and ordinary debts and on all cash deposits and guarantees due to Egyptians and foreigners domiciled or resident in Egypt.

This privilege is issued to avoid double taxation of the interest which is, in credit firms, the major part of the establishment's profits which in turn is subject to the Schedular Tax as an interest and then when entered as the firm's profits becomes liable to the Tax on Commercial and Industrial Profits.

Specific limitations are provided by the Law as to differentiate between the various banking categories. Ordinary commercial banks as distinguished from industrial, agricultural or other types of banks which deal only with issuing loans on large scale and in considerably big sums. The first category enjoys the exemption of the tax on the interest if a) the advance should be a short term loan, not more than one year; b) the amount of the advance should be relatively small; and c) the rate of interest is flexible, i.e. the establishment issuing the credit has the freedom to change the interest rate at any time.

Industrial, agricultural and other establishments which are specialized in issuing loans against property mortgages are exempted if the loans issued do not exceed £E100,000. The cause for such limitation is alleged to be the fear of companies borrowing their capital from banks at a low rate of interest exempted from income tax instead of issuing debenditures which yield interest subject to taxation. In other words the legislator had to fill the loophole and to prevent evasion through the course of borrowing the enterprise's capital from banks instead of issuing debenditures for public subscription which are subject to Income Tax.[1]

The motive behind this exemption is the protection of the banking and credit system of the country through the lifting of double taxation on one of its basic source of business.

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(1) Article 1, Law No. 14 of 1939.

3) Holding companies are presumed to pay Income Tax on the distribution of dividends including that part derived from the dividends distributed by the affiliated companies which had already paid their share of Income Tax. Therefore, to avoid double and even multiple taxation it was provided in the Schedular Income Tax Law that the distributions of the affiliated companies are deducted from the parent company's distributions in computing the tax liability.[1]

In 1957 special provision was issued to avoid double taxation on 'investment companies' which invest at least 90% of their capital in securities and other moveable property. As the major object of an investment company is to help small individual investors to become shareholders of other companies through an organised enterprise which is inclined to have a comprehensive experience in capital investment. Thus the Egyptian Government following the plan drawn to stimulate investment by internal incentives and to avoid the evils of double taxation on this type of establishment it had to grant an exemption to such companies regarding their distributions derived from their investments from the Schedular Income Tax on Moveable Property.[2]

To sum up, it is quite obvious that the Egyptian tax system especially Income Tax has provided considerable ways and means in order to avoid double or multiple

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(1) Article 6, Law 14 of 1939 states: "When an Egyptian corporation has received, in return for its participation, in kind or in cash, in the share capital of another Egyptian or foreign corporation, bearer shares or securities, the dividends for each financial year paid out by the former corporation shall be exempt from the tax on income derived from moveable property laid down in Article 1 of this law, in proportion to the profits on nominal shares or other interest bearing securities realised by the corporation during the above mentioned financial year, provided that such shares shall be registered in the name of the corporation and that tax shall have been paid on the profits which have accrued on the income derived from each moveable property ......"

(2) Law No. 95 of 1957.

taxation of the same income as the tax system is relatively complicated and overlapping in some casses. It has been always the nature of a multiple income tax system to include various conflicts or overlappings which result in double or multiple taxation which has to be avoided carefully through legislative means. In the same time care should be paid in forming the necessary provisions in order to prevent any misinterpretation of such provisions which might lead to under-taxation or evasion. Thus if evasion or even avoidance takes place the equity problem starts to rise and the balance of distributing the tax burden among taxpayers is liable to be distorted.

(B) International Double Taxation

The principles and the bases upon which the tax system is constructed differs from one country to the other according to the fiscal policy aimed to accomplish and according to the socio-economic conditions of the country. Some countries levy a 'unique' income tax while others levy a schedular income tax supplemented with a general income tax. Moreover, the basis upon which income liable to tax is computed differs from one system to the other, depending on the fiscal policy it follows.

The problem of double taxation between nations is due largely to the mass exploitation of income taxation as nearly every nation introduced income taxation and is setting its system in the form which can bring in the greatest amount of revenue. The consequences of such action imperil the free movement of capital and work, as well as distorting the equitable distribution of tax burdens. The problem of double taxation simply originated through the extension of tax jurisdictions and the overlapping of tax ideals and methods adopted by the different tax authorities regardless of the personal status of the income recipient or his ability to pay.

International double taxation has been widely discussed especially after World War I by the League of Nations, and also in the period following the last War by the United Nations. Economists as well contributed in the study of this problem and solutions have been discovered, but the problem itself still exists as the causes are not removed from the roots. To explain the fundamental causes behind double taxation the theories underlying the imposition of income taxation have to be briefly elaborated.

Theories Supporting the Imposition of Income Taxation:

The original classical theories of taxation are the 'cost theory' and the 'benefit theory'. According to the 'cost theory' it was held that the individual ought to be taxed in accordance with the cost of the service performed by the State. Under the 'benefit theory' the tax should be imposed in relation to the particular benefits conferred by the State upon the individual. Both theories are helpless in solving the problem of double taxation as the individual may reside in one country where he enjoys civil rights and his property is located in another country. Therefore, he could be subject to taxation in the first country and also on his income derived from his property situated in the other country where it is maintained and defended. Neither theory is commonly adopted at present.

The theories of 'sacrifice' and 'ability to pay' superseded the above mentioned theories. The 'sacrifice' theories are based on the assumption that each individual should sacrifice equally part of his income towards the aggregate needs of the State. The ultimate idealogy of these theories is that the tax burden as a whole should be arranged to provide the smallest burden as possible. On the other hand the 'ability to pay' theory assumes that every Government has to raise a certain amount of revenue to meet the public expenditure, therefore, every individual ought to contribute towards the needed revenue in accordance with his financial ability.

The above mentioned theories did not influence and govern international competence in taxation.[1]

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(1) League of Nations; Report on Double Taxation, April 1923, by Profs. Bruins, Einandi, Seligman and Sir J. Stamp, pp. 18-19.

They also did not contribute to the construction of effective practical bases for distributing tax burdens between nationals and foreigners or between residents in the country and those who derive their interests from it. The basic factor which governs the imposition of any tax is the need for revenue rather than the theoretical principles. As each country differs economically and, in most cases, they may either be a capital-importing or capital-exporting, the taxation policy depends to a great extent on the economic status of the country. Consequently, one could emphasise that the above theories did not help to solve the problem of international double taxation. Thus we must continue the exploration to discover the most suitable theory which might be inclined to solve our problem. The following are the practical theories which face the tax legislators in setting up any income tax system from the liability viewpoint.

1. Political Allegiance: It is the oldest principle which guided income tax liability. A citizen of a country is subject to income tax whether he lives within or without his country and whether he derived his income from sources inside or outside his country.

Political allegiance has ceased to have any significance in most of the income tax systems when the commercial relations between the different nations developed and as the actual population of a country is not limited to citizens. Therefore, to tax only the citizen and exempt the foreigner, even from taxes on income derived from the country, is inadequate and against the equity principle.[1]

This principle has a negative significance in most old established income taxes, while it is adopted in the Egyptian Income Tax system.

(1) Seligman, Essays in Taxation, p. 111.

4

2. Economic Allegiance: This principle has already gained power and importance in most tax systems as it proved to be relatively adequate as a basis for a tax formula. This doctrine, as put in Seligman's words, is based on that: "Every man may be taxed by competing authorities according to his economic interests under each authority. The ideal solution is that the individual's whole faculty should be taxed; but that it should be taxed only once, and should be divided among the tax districts according to his relative interest in each."[1]

Economic allegiance should be interpreted in connection with the principle of 'ability to pay' in order to reach a fair and justifiable basis for the imposition of income taxation. But in order to achieve a clear definition of the 'economic allegiance' doctrine which in turn would help in accomplishing a solution of the international multiple taxation problem, the following principles have to be elaborated.

a) Origin or Situs: The origin of wealth and income is one of the basic fundamentals ruling the taxation of business profits and also, to a considerable extent, income derived from employment. In the case of income taxes the principle of origin is referred to the origin of the income or the place where the earnings are created.[2] Sites or location are terms normally used to identify the place where property is located and therefore, a tax on such property has to be levied by the jurisdiction of the country in which such property is located.

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(1) Seligman, Op.cit., p. 113

(2) League of Nations, Op.cit., p. 24

b) Residence and Domicile: The concepts of residence and domicile are closely connected to the principle of 'economic allegiance' and it mostly governs the liability of individuals to taxation. It also has a considerable significance within the frame of business taxes especially incorporate taxation.

By 'domicile' it is meant the place where a person chooses to exercise his political rights and where he is summoned to discharge political obligations.[1] A person can be domiciled in one country and resident in another. Such residence could be temporary or permanent and, therefore, domicile and permanent or habitual residence coincide. The interpretation of these terms differs from one country to the other and thus the problem of double taxation arises. In order to avoid double taxation, domicile or habitual residence must everywhere be interpreted alike in connection with income taxation. By 'residence' we mean temporary residence which might be for a short or a long period. The fixation or the determination of the time factor upon which the residence depends is usually decided by the tax authority. Such decision is in reality different from one system to the other and, therefore, the problem of double taxation remains acute.

Now after reviewing the basic principles underlying the imposition of an income tax, one has to decide what are the most adequate principles to be adopted by all income tax systems and to follow a single pattern in order to avoid internation multiple taxation.

In fact any income tax system now in existence adopts more than one of the above mentioned principles and, thus, an international single pattern is a

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(1) Ibid, p. 25

difficult and absurd solution for double taxation problem. The League of Nations had studied the problem and put forward to all interested nations a pattern according to which taxes, income, property, and death duties, should be levied in order to avoid international multiple taxation.[1]

International tax agreements were devised by the League of Nations as the most adequate solution for the problem of double taxation and it established a model agreement to be a clear guidance for those countries who would reckon to solve the problem through tax conventions.[2]

Principles of Income Tax Liability within the Egyptian System:

Practical application of the above theoretical principles to the Egyptian Income Tax is unavoidable as such study is important in the discovery of the basic causes of international double taxation in relation to the Egyptian income tax.

The Egyptian taxes on income, as previously explained,[3] are composed of the Schedular income tax with its impersonal feature and the General Income Tax with the personal character. The Egyptian taxes on the returns of land, houses and movable property and on the corporations' profits, are impersonal. While taxes on other source of income enjoy a relatively personal characteristic.

a) Movable property, i.e. securities, shares, interest and others, are liable to the Schedular Income Tax if they are derived from firms carrying on

(1) Several studies had been made by the League of Nations during the inter-war period by economic experts. The most significant research was that prepared in 1923 by Profs. Bruins, Einandi, Seligman and Stamp.

(2) League of Nations, London and Mexico Model Conventions, Commentary and Text.

(3) See Appendix to Part I of this work.

business within Egypt regardless of the domicile or the nationality of the beneficiary. Therefore, the 'economic allegiance' and 'source' of income governs the liability of this type of income. If a person lives in another country which adopts the principle of 'political allegiance' or 'domicile' and derives part of his income from his investments in Egyptian company, such income would become subject to double taxation. Moreover, the 'residence' principle rules the liability to the Schedular Tax on movable property if the individual is resident or domiciled in Egypt and derives his income from foreign movable property.

b) Commercial and industrial profits of all firms, Egyptian and foreign, are subject to tax according to principle of 'economic allegiance' and the 'territoriality of taxation'.

c) Wages, salaries and other emoluments are subject to the Schedular Tax if they are paid by the Egyptian Government or any Egyptian public authority, e.g. Provincial Councils, municipalities, and other public organisations, or by any other enterprises residing in Egypt. If such emoluments are paid by a foreign firm residing abroad, for a work done in Egypt, they become subject to tax. Thus more than one principle applies to income derived from emoluments; residence of the employee, the place of the work for which emolument is paid and the payer of the emoluments.

d) Income from professions or vocations is liable to tax if each profession or vocation is practised within Egypt and therefore, the principle of 'economic allegiance' and that of the 'territoriality of taxation' governs the liability to the Schedular Tax.

The General Income Tax, as a supplementary tax on income, adopts different principles:

1. 'Political allegiance': the Income of any Egyptian wherever he resides is subject to tax;

2. 'Origin': income arising from Egyptian sources to a foreigner residing abroad is subject to tax;

3. 'Residence' and 'domicile': any foreigner residing or domiciled in Egypt is subject to tax on all his income from sources within Egypt and from overseas.

From the above review of the principles underlying Egyptian Income Taxes liability, it is significant to deduce that the adoption of such different principles makes the solution of the international double taxation problem a remote one. Another fact is that liability underlying a specific Schedular Tax implies the application of more than one principle, besides that the General Income Tax still follows the out-of-date 'political allegiance' principle which is proved to be impractical in most income tax systems. For example, if an Egyptian lives in Britain and derives all his income from that country, he will be liable to both the Egyptian General Income Tax and also to the U.K. Income Tax. But it might be administratively impossible for the Egyptian Revenue authorities to assess the tax and, therefore, the Egyptian tax is bound to be evaded. Another fact is that the number of Egyptian nationals living permanently abroad is very few and any attempt to assess such nationals would prove fruitless without a very close co-operation between the various foreign Revenue Authorities. In general, it has been proved during the last decade, since 1949 when the Law of General Income Tax was issued, that the Egyptian Taxation Department has been meeting several administrative difficulties which make the assessment of this tax from Egyptians habitually

9

resident abroad a difficult task. Consequently, it would be more adequate and equitable if such provisions are repealed regarding the taxation of Egyptian nationals residing abroad and deriving all their income from non-Egyptian sources.

To make the picture more comprehensive, it would be profitable if we adopt the suggested principles in the London Bilateral Convention model to avoid double taxation drawn up for the League of Nations in 1946, and apply them to the Egyptian system. The following table illustrates the situation:

Source of Income	Preponderant Element	
	London Model	Egypt
Real Property	O	O
Mortgages (property)	O	O & D
Mortgages on sea and/or air vessels	O (Reg.)	O & D
Industrial & Com. or Agric. enterprises	D	D
Operation of ships or aircraft	D	D
Labour or personal services	D	D
Liberal professions	D	D
Government payments not to Com. agents	O	O
Shares in corporations	D	D & O
Shares belonging to foreign domiciled Co.	D	D & O
Bonds, securities, debenditures etc.	D	D & O
Immovable Property, mines, quarry ... etc.	O	O
Use of patent, trade marks	O	O
Pensions and life annuities	D	D & O 1)
All factors 2)	D	D & O

D = Domicile or Habitual Residence   O = Origin or Situs

1) If they were given for work done in Egypt.

2) The State of domicile retains the right to tax the entire income, but deducts from its tax on such entire income an amount equal to the tax collected by the other State. If the taxpayer is considered as domiciled in more than one State, the tax which depends on fiscal domicile shall be imposed in each State in proportion to the period of stay in each or according to any proportion agreeable to the competent administrators.

Source: League of Nations, London and Mexico Model Tax Conventions, 1946.

The Fiscal Treatment of the International Double Taxation:

Various devices have been proposed as a solution for the problem of international double taxation specially by the League of Nations in its several reports on this subject.[1] The following is what is considered to be the basic realistic methods of relief from international multiple taxation. Such methods could be achieved either by a unilateral action through national legislation or by a bilateral action through international agreements. Unilateral relief has been sucessfully used especially by capital exporting countries giving a tax incentive to their citizens engaged in foreign trade and investment. On the other hand different capital importing countries offered tax exemptions to foreign capital through its national tax legislation. Multilateral conventions could be devised to help curtail the multiple taxation between the various countries whose tax systems tend to overlap, but such conventions "have not proved practical."[2]

The major methods applied to avoid international double taxation or to eliminate it could be enumerated in the following:

1. The allowance of the foreign income tax as a deduction from the net taxable income: This method is adopted by almost all income tax systems which do not approve of offering other unilateral reliefs for foreign income. It is quite obvious that this method is easily condemned to be of minor use or even useless in overcoming the double taxation of foreign income as, in fact, the tax liability would be only reduced by that fraction of the national tax presumed to

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1) League of Nations: a) Report on Double Taxation, by Professors Bruins, Einandi, Seligman and Stamp, 1923; b) Report and Resolutions on Double Taxation and Tax Evasion; 1925; c) Report on Double Taxation and Tax Evasion; Model Conventions for the Prevention of Double Taxation, 1928; d) London and Mexico Model Tax Conventions, 1946.
2) United Nations, The Effects of Taxation on Foreign Trade and Investment, 1950, p.40

be levied on the foreign tax paid, e.g. if the foreign tax is £100 and the national tax rate is 10%, the reduction in the over-all tax liability would be £10.

The impact of such method on a capital-exporting country is very grave as the foreign enterprises in any country could have to resist the loss through the difference of the tax burden as compared to the national enterprises which bear one tax only. If T is the total tax liability, tn is the national tax liability, Y is the net income and R is the tax rate of the parent company's country therefore the liability of the foreign company is:

$$T = t_n + (Y - t_n)\,R$$

and the liability of the national company with the same net income is:

$$T_1 = t_n$$

therefore it is obvious that $T < T_1$ as $t_n > t_n \quad (Y - t_n)\,R$

2. <u>Tax Credit</u>: Under this method taxes paid to a foreign government may be deducted from taxes levied on the same income by the taxpayer's domicile government. This method renders a substantial privilege to the taxpayers of capital-exporting countries as they would be paying only the highest of either their home tax or the foreign tax. On the other hand capital-importing countries, having a lower tax rate, in most cases, are not inclined to give further tax incentives to foreign enterprises as the final result would not be effected. Furthermore, it might be sound for capital importing countries to raise their tax liability to the allowable credit in order to increase their tax revenue and without affecting the taxpayer's position. This might not be practical as most foreign enterprises do not belong to the same country, but such foreign enterprises usually belong to different countries which differ in their tax treatment of the profits derived from abroad. Therefore the capital importing country has to offer fiscal incentives to attract foreign capital. Some capital exporting countries such as the U.K. limit their credit to a percentage of the foreign tax.(before 1953)

12

This method, however, has got different gaps and loopholes; the determination of concept 'source of income' and its interpretation, whether taxable income include that derived from trade within the country or also from trade with other countries? Taxes subject to credit have to be defined very carefully as to correspond with the foreign taxes. In fact, tax agreements were able, to a great extent, to close the gaps and fill up the loopholes by "providing definitions of concepts and specific enumerations of taxes covered."[1]

3. A Reduced Tax Rate: According to this method a special reduced tax rate is applicable to foreign income. Usually the fixation of the rate is provided in tax agreements.[2] This device is not widely used as it does not help to avoid completely double taxation but, on the other hand, it has some advantages. The most significant one is that it eliminates the loss of revenue of the crediting country, besides providing a more justifiable division of tax revenue between the parties of the agreement. This method also helps in the detection of tax evasion especially in the case of income derived from foreign securities.

4. Exemption of certain types of Income: This is the extreme method used for solving international double taxation. Under this device foreign income is exempted from taxes levied by the country where the taxpayer is resident or domiciled. Other types of income as well could be exempted from taxation if such incomes were subject to taxation in another country.[3]

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1) Ibid, p. 50.
2) This device is adopted in the Anglo-American tax agreements. Article XI of the Agreement between the U.S.A. and Canada of March 1942 provides that the maximum rate of withholding tax for income of non-residents if 15%. See: U.N. International Tax Agreements, vol. I, p. 106

3) Under the French Income Tax (Dec. 1948 Reform) foreign business profits of French enterprises are exempt from tax if they arise from operations or a separated establishment abroad. Egypt as well applies the same principle as in France.

Reciprocity is the usual condition governing the offer of such privelege as in the case of the exemption of foreign maritime and air transport enterprises from taxation on their profits derived from local operations. If a country does not have shipping or air transport enterprises, this method is inclined to be unfavourable and the agreed system of allocation of profits has to be applied to prevent double taxation.

This device as the other ones has its advantages and disadvantages. The loss of revenue of a country granting such a relief is the basic apparent danger especially if this country does not have overseas business branches or subsidiaries. Moreover, this device encourages evasion of taxation as there is no reliable assurance that the exempted income will be taxed in the other country. The only principal advantage of such a method is its simplicity from the administrative standpoint.

In general the practical use of this device has proved adequate in the case of maritime and air transport enterprises under reciprocal agreements.

5. Allocation of Income: Income under this method is usually allocated according to the agreement of contracting countries who include the basis of allocation in the tax agreement. Usually they divide taxable income according to its source and type. The allocation depends on the interpretation of : a) various categories of income, e.g. income from movable and immovable property, income from trade and others, b) residence, c) domicile, and d) source or situs. The League of Nations, as previously mentioned, set down the basic principles of income allocation to be taken into consideration when concluding any bilateral or multilateral tax agreements.

The allocation method creates one of the most difficult problems in its application, that is the taxation of business income realised from activities carried on in more than one country.[1] Several devices are used for splitting up the profits of such enterprises. Tax agreements usually include the fundamental basis of profits' allocation. The following are the various methods used in allocating the total profits of an enterprise: a) separate accounting system for each branch or any dependent permanent establishment carrying on activities in a foreign country, b) a fixed percentage of the branch's gross receipts; and c) using coefficients, e.g. local assets, gross receipts or number of hours worked; whenever it is impossible to decide accurately the branch's profits, i.e. if such branch constitutes an important element of profit-making of the parent enterprise.[2]

The significance of this method could only be proved if it is adopted by countries enjoying nearly the same level of economic development. Capital exporting countries are deemed to lose a considerable amount of tax revenue in adopting the allocation method with any capital-importing country as the latter does not have any branches operating in the former countries which could offer a similar treatment or "a satisfactory 'quid pro quo'."[3]

To complete the picture a comparative study of the various methods has to take place. It is appropriate for the comparison to take the following hypotheses: An enterprise having its head office in a capital-exporting country "A", and investing part of its capital in another country "B". Net income realised in country "A" within a specific year was £10,000 and £3,000 from business carried on in country "B". Tax rate in country "A" is 30% and in country "B" 20%.

Reduced rate used in column (3) is 10% on foreign profits.

1) League of Nations, op.cit., pp. 44-46
2) U.N., op.cit., p. 45
3) Ibid, p. 46

15

TABLE 26: Comparative Illustration of Methods devised for the Prevention of International Double Taxation.

	Exemption (1)	Credit (2)	Reduced Rate % (3)	Tax Deduction (4)
Net Profits in Country A	£10,000	£10,000	£10,000	£10,000
Net Profits in Country B	3,000	3,000	3,000	3,000
Tax Liability in Country B	600	600	600	600
Total net tax liability	3,600	3,600	3,900	4,320
Effective Rate on Total Profits	27.7%	27.7%	30%	33.3%

From the above table, it is clear that the credit method and the complete exemption of foreign income from home taxes render favourable results. The final impact of national and foreign taxation on aggregate profits is deemed to be the same under both methods. Under the reduced taxation method the total liability depends on the reduced rate levied upon foreign income.

Bilateral and Multilateral Tax Agreements as an Adequate Solution of Double Taxation Problem:

Bilateral tax agreements have proved an adequate device in detecting international double taxation during the last half century and more specifically during the post World War II period.

Up till the First World War the basic motive for concluding tax agreements is the desire to re-organise the fiscal matters concerning European trade. After World War I most of the countries introduced and established an income tax system on different bases which caused more harm to trade than ever existed as the problem of double taxation became acute. Thus, tax agreements were needed to solve these international fiscal conflicts which made international trade and capital investment relatively impossible. Most of the tax agreements which were concluded in the inter-war period tried only to organise the taxation of maritime companies and foreign commercial banks.

After World War II the need for tax agreements and other fiscal provisions became a significant stimulant for capital investment through its immigration to underdeveloped countries. In the meantime most underdeveloped countries adopted or developed direct taxation, especially income taxes; therefore the problem of double taxation on income had to be solved in order to stimulate foreign capital investment. Underdeveloped countries are confronted by two conflicting desires; the need of revenue for the expanding expenditure and the need for foreign capital for further development. Therefore in order to achieve one of those aims the other has to be sacrificed. To stimulate foreign trade and investment the underdeveloped country has to offer tax incentives besides other fiscal ones which would reduce the public revenue. In general tax measures are used as an adequate instrument for the channelling of foreign investment and trade.

Tax agreements to avoid double taxation are used as a fiscal stimulant for foreign capital in underdeveloped countries. But such agreements are also concluded between developed countries not as a stimulant for foreign capital but as a pure device to avoid double taxation between two equal countries. The underdeveloped country which believes in tax agreements with capital exporting countries to stimulate the latter's capital has to be sure that every capital exporting country does not offer a tax credit against foreign taxes, otherwise any tax unilateral or bilateral though agreements would prove useless.

In fact, and according to the present situation, many of the independent underdeveloped countries have not concluded tax agreements to avoid international double taxation of income with other developed countries. The basic reason for this fact must be sought in the economic unbalance between capital-exporting and capital-importing countries which allows less scope to the bargaining factor involved in the tax credit provision in the major-capital-exporting countries has lessened the significance of bilateral agreements for the underdeveloped countries which are anxious to assure foreign investors of freedom from the rigidity of double taxation.[1]

From the above analysis the tax credit method offers powerful protection for an effective income tax system in underdeveloped countries. Although there are various considerations, which are mentioned above, contribute to weaken the incentive of underdeveloped countries for the conclusion of bilateral agreements with capital exporting countries which offer a credit system, it is more beneficial

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1) Ceylon, Burma and Israel have signed tax agreements with the U.K. in 1950 in order to gain the benefit of tax credit up to the full amount of the U.K. tax in absence of a tax agreement. See. U.N., International Tax Agreements, Volumes I and II.

to the former countries to become incorporated in bilateral agreements which would serve to bring fiscal relations between contracting countries to an effective subtle condition regarding trade and investment. Bilateral tax agreements could be widely used as instruments for co-ordinating the tax relationship between the contracting countries and it could be said that such agreements have achieved the co-ordination of international tax relations of developed countries and their dependencies as the case of most tax agreements concluded between the U.K. and its colonies, Dominions and also the Commonwealth countries. But in the case of underdeveloped countries tax agreements have not yet served their purpose in simplifying international tax relations or played their expected role as an incentive for foreign capital investment.

The problem of double taxation was not considered an element disturbing the fiscal structure in Egypt. Therefore no major legislative provisions were introduced to eliminate any presumable international double taxation. Until 1952 Egypt did not conclude any type of tax agreement as it was the overwhelming idea that any tax agreement would grant foreign enterprises carrying on business in Egypt an advantage, or more specifically "capitulations" over the national enterprises even if these agreements were based on reciprocal treatment as there were very few or no Egyptian overseas businesses.[1] Egypt as an underdeveloped country followed the ideology put forward by the League of Nations and the United Nations as any underdeveloped country does "not have an important stake in relieving double tax burdens resting on the first investments of (her) own citizens."[2]

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1) This view was actually due to the 'complex' resulting from foreign domination of Egyptian economy and other aspects during the period previous to 1937, when all capitulations were abolished by the "Montreux Treaty" of 1937
2) United Nations, International Tax Agreements, Volume II p. xi.

On the other hand the Egyptian Government's idea was directed towards the deterring of capital flight from domestic investment. Therefore, double taxation was believed in this case, as an important factor; e.g. a tariff, to keep capital from flowing outside the country.

But in 1952 after the Revolution need for incentive to stimulate capital investment and also to approach indirect revenue; e.g. through tourism, dues from the operation of airports and harbours, induced the Government to grant fiscal privileges to special sections of the economy. The first fiscal Law towards this end was issued in August, 1952 allowing the Government to exempt foreign air transport enterprises from income tax on its profits on reciprocity basis. Afterwards in December 1953 an amendment to this law took place to include a further exemption to foreign air transport firms from tax levied on its movable income.[1] Reciprocity is the basic principle for exemption under such provisions. Up to 1955 one treaty was concluded between Egypt and Switzerland while negotiations with other countries took place.[2] The exemption of foreign aviation companies carrying on business in Egypt and abroad became indispensable for attracting tourism and to increase the amount of traffic using Egyptian airports and hence increasing traffic dues and other revenues. The geographical situation of Egypt, besides this fiscal incentive, would in fact achieve the desirable aims.

Various foreign maritime companies carrying on business in Egypt decided to raise the question of its liability to the Egyptian income tax to Courts as

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(1) Law No. 169 of 1952 amended by Law No. 588 of 1953.
(2) These countries are: Jordan, Syria, Norway, Ethiopia, Finland, Holland, Italy, U.K., U.S.A., Canada, Saudi Arabia, Iraq, India, Pakistan, Greece, France, Denmark, South Africa, Sweden, Iran and Belgium.

they believed that they should be immuned from the Egyptian tax. The Court's decisions were in favour of the Companies and thereafter in January 1953, a law was passed to delay the collection of taxes due on these foreign companies pending a fiscal decision of the Egyptian Supreme Court on the problem of their liability. The trend at that time was a complete exemption of such companies on reciprocal basis.[1]

Profits arising from speculations in the Egyptian Cotton Future Market (Alexandria) for foreign firms carrying on their activities outside Egypt are exempted from the tax on Commercial and Industrial Profits.[2] This action undertaken by the Egyptian Government was a necessity in order to protect the cotton market and the fluctuations in prices. Hedging and settlements by foreign purchasing firms are indispensible in the cotton market, and therefore any profits realised from these contracts could be liable to the Egyptian Tax if it is carried by an 'establishment' residing in Egypt. As Liverpool Cotton Market was the principle settlement market for Egyptian cotton, and as profits arising from hedging operations in Liverpool Market and Alexandria Market are exempt from the U.K. tax, it became a necessity to grant the above mentioned exemption for the stabilization of the Egyptian Cotton Market.

In 1955 the Egyptian Government after a detailed study of the benefits which might be gained by concluding comprehensive tax agreements with other nations especially capital-exporting ones, passed a law allowing the conclusion of bilateral or multilateral tax agreements on reciprocal basis to avoid international double taxation.[3]

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(1) Law No. 43 of 1953. No further information on this question is available.

(2) Law No. 470 of 1955.

(3) Law No. 542 of 1955.

The Egyptian experience, however, in the field of double taxation agreements, especially within the field of income taxation, is very limited. The first two Conventions regarding income double taxation were concluded in 1958 between the United Arab Republic (Egyptian Region) on the one side, and Sweden and West Germany on the other.

The question of the adequacy and the expediency of such conventions has to be judged from a long term point of view.[1] However, there are two main categories of arguments, for and against the conclusion of double taxation treaties. The following are the arguments against:

1) It may not seem advantageous to Egypt to conclude such agreements, on the argument that Egyptian investments abroad are too negligible to benefit from such agreements;

2) Moreover, it was argued that the loss of revenue arising from the tax privileges granted through such agreements would overstep the benefits arising from new foreign investments; and

3) A final argument against the conclusion of double taxation agreements is that the tax privileges granted would discriminate against locally financed enterprises, and thus give rise to a breach of equity.

On the other hand, however, we should not base our judgement on the adequacy of these agreements on a short term policy viewpoint, although present sacrifices may be obvious. A long term fiscal policy concerning foreign capital investment is deemed to be more beneficial than a short term one. Therefore the justification of any fiscal measure has to be judged on its long term merits. The two recently concluded agreements do establish the basis on which income taxes are imposed in each country in order to prevent any double taxation of the same income.

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(1) Our discussion here is basically theoretical as Egyptian experience in the field of double taxation agreements is new and therefore limited.

However, no basic concessions either to individuals or to firms have been granted through these conventions. Accordingly, such agreements could be considered simply as a grinding tool which leads towards a better understanding of the fiscal legislation of the contracting countries, which would facilitate capital movements. No actual loss of revenue would occur under such agreements as no exemptions are granted to foreign enterprises of foreign individuals on their income arising from Egyptian sources and activities carried out in Egypt. Consequently we could emphasise that Egypt would benefit ultimately from the conclusion of such agreements - which do not include any direct or indirect tax exemption - especially with capital exporting countries.

P A R T III.

SUGGESTED REFORMS ; MAJOR POLICY GUIDS

(CONCLUSION)

" Change is one of the constants in our kaleidoscopic world." Sherman J. Maisel, Fluctuations , Growth and Forcasting, p. 3.

CHAPTER VIII

A Design for more Effective Income Tax

In our study we have analysed the various aspects of the Egyptian income tax system. Now, after reaching various detailed conclusions in the course of the foregoing analysis, it appears necessary to conclude our discussion by putting forward the recommendations required to establish a more effective and efficient income tax in Egypt.

Our main purpose in this concluding chapter is to devise a more effective income tax which will be competent to reach the following objectives:-

(i) Decrease the inequality of the tax system where indirect taxes with their regressive nature outweigh direct taxes. Income taxation has to be developed to play the main role in reaching this objective with the aid of exemptions, and reliefs as well as the rate structure;

(ii) Increasing the flexibility of the tax through the rate structure and increasing the efficiency of the administrative machinery. This flexibility is needed to raise revenue for economic development and increasing the role of the tax as an economic stabilizer. Public revenue is badly needed too for public investment, which is increasing at a rapid rate, to compensate the decline in private investment; and

(iii) Minimizing the disincentive effects of the tax on private capital formation through the introduction of a series of tax incentives to business enterprises. However, the ultimate aim, herein, is to construct an income tax which would be able to play a dual part in the overall economic development; raising revenue for public capital formation and encouraging private investment.

The reforms proposed in our conclusion are two; the first deals with the very immediate future, i.e. the transitional period before introducing the major reform; and the second is confined to an overhauling of the present income tax for a long-run application. Most of the arguments behind these reforms have been discussed before in the various sections of this study, and therefore it seems undesirable to repeat such arguments in framing the outline in this final part. By and large our main object as above mentioned is to present an outline of an effective income tax based on our previous analysis.

I. Short-Term Reform[1]

In fact our recommendations for the short-term changes in the tax are only to help us in liquidating the problems of the present system before introducing the long-term reform where the income tax system has to be overhauled. Therefore, after liquidating the anomalies and heavy burden of the unassessed tax, public policy makers have to set up a long-run tax policy, which includes the reformation of the income tax. This policy should be ready for application after the expiry of the transitional period.

The main object of the proposed changes within the transitional period is to collect the unassessed tax without creating inequities and unnecessary complications. The immediate changes are two-fold; legislative and administrative.

(A) Legislative Measures:

(i) Legislation has to be enacted in order to provide for a quick

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1) The length of the short-term reform depends on the ability of the Taxation Department to clear up the problems and the cases before the Courts. This period could be as short as two years or longer, up to five years. Any period longer than five years would be inappropriate as the long-term reforms should be introduced as soon as possible in order to create a stable tax system in the first stages of economic development.

settlement of the cases already at court or in dispute.

(ii) Abolishing the discrimination in tax treatment between self-employed graduates and other taxpayers. Income tax should be imposed on the former group on their actual earned income instead of the present treatment based on the payment of lump sum tax according to the number of the years of practice. Equity, would thereby be achieved and revenue from the Schedule Tax on Non-Commercial Professions could be increased at least by half (the 1957-58 revenue from this particular Schedule was about half a million pounds).[1]

Retrospection of the legislation could be sought in order to remove the inequity caused by the introduction of such discriminatory treatment, i.e. partial exemption in 1955.

(iii) In regard to the inequity and loss of revenue resulting from the exemption of agricultural profits (other than profits realised through corporations) a progressive sur-tax could be imposed on the present Land Tax. However, the rate of progression would be based on the number of feddans (acres) comprising the agricultural tenure.[2] This device will be only temporary for the transitional period as the long-term reform would include these profits in the basic system of income tax. By this device equity would be partially achieved and extra revenue raised.

(iv) The banking institutions could be authorised through the Government and the Central Bank to provide credit facilities with a low interest rate for taxpayers to enable them to pay their accumulated tax debts. Interest paid by taxpayers should, therefore, become deductible from taxable income.[3]

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1) For the detailed arguments on which this recommendation is based, see Chapter IV.

2) See Chapter IV on this point.

3) The economic impact of this measure is discussed later.

(v) A percentage deduction, say 5 per cent to 10 per cent from the tax debt could be made available to taxpayers who pay their tax debts within an early period. The loss of revenue through this privilege is compensated by the immediate availability of cash funds which are needed for further investment by the public sector. This measure includes a considerable degree of inequity but it is an unequivocal matter in this short transitional period. France adopted this measure in 1949 when introducing the new income tax reform of December 1948.

(vi) Increasing the present inadequate penalty provisions and introducing imprisonment for tax evadors in addition to the present fines.

These are the main legislative measures which could be provided immediately in order to reach the main object in the transitional period, that is to pave the way to the introduction of a more effective income tax. Legislative measures alone without effective and adequate administration are, however, fruitless, and, therefore great weight has to be placed on the administrative side of the picture.

(B) Administration in the Transitional Period

The inefficiency of the administrative machine is not expected to alter greatly in the near future even if we introduced the up-to-date new techniques. This is due to the fact that the accummulated irresponsibility and corruption in the administration as a whole is a heritage of centuries and not of a short period. Therefore, one cannot rely to any great extent on reforms instituted in the administration of the Taxation Department in Egypt. On the other hand this fact should not hamper our legislative reforms for the transitional period as we have to reach the aim at the most reasonable cost.

The following are the principal administrative reforms designed for the execution of the above mentioned legislative measures:

(i) Mobilization of the necessary personnel to assess the arrears, especially those of the Tax on Commercial and Industrial Profits and on Non-commercial Professions. The basic aim is the assessment of the Schedular Taxes and the General Income Tax up to date.

(ii) Not much regard should be paid, within the transitional period, to the maxim of economy in taxation, as the basic derive will be towards the quick assessment of arrears. A loss of revenue due to the increase in the cost of collection is obvious but such inevitable loss would be only temporary.

(iii) A nation wide campaign through various ways and means is needed to explain the advantages of the early payment of the tax debt and the national objectives behind the tax payment in general.

The Economic Issue of the Short-Run Policy

A relative increase in the public revenue due to collection of arrears in the transitional period is inevitable.[1] Therefore, the economic effect of such an increase would depend on the way the Government is going to spend it. If such an increase is directed towards public investment the result should be the acceleration of productivity and an increase in the national output. If it is assured that the tax debt might be paid from private savings the ultimate effect would depend on two factors; first the channels through which such savings were supposed to be invested if they were not paid to the Treasury; and second, the form in which the public sector is going to dispose of the tax revenue. In a developing country like Egypt such an increase most probably would be directed to public investment either in social overhead schemes or in contributing to new

1) The amount of uncollected income taxes was about £E33 million in 1955 according to the latest available data. See Chapter III.

ventures which the private sector is avoiding for one reason or another.

If the payment of the tax debt by the private sector is through dissaving, the result would be a decrease in the domestic investment. On the other hand, if such dissaving came from hoarded money or precious metals and not from productive capital, the result would be different. The effect on the economy in this case would be a rise in the price level due to the increase in the aggregate demand over aggregate supply.[1] On the other hand an increase in the domestic output would become most probable if such dissavings were not expended on unproductive goods and services.

In cases where taxpayers were unable to pay the tax debt in full or in part through limited (in time) instalments, monetary measures might be relied on. Credit opportunities could become available for taxpayers to pay their tax debt. The economic incidence of such measures depends mostly on the way the credit is created and the amount of such credit. An increase in the supply of money through the Central Bank might lead to inflationary tendencies as a result of the increase in aggregate demand which in turn would raise the price level. The ultimate effect depends; firstly, on the percentage of the increase in the supply of money to the aggregate amount of money supply; and secondly, on the percentage increase in the domestic output.

By and large, if such credit measures were undertaken and an inflationary trend resulted, monetary policy measures would have to be applied to counteract this trend. Fiscal policy devices could be applied as well but their effectiveness would generally be considered less than monetary policy measures due to the time lag in the application of the first type and the inefficient administrative machinery in control. Finally, if such an inflationary trend

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1) In a less-developed economy aggregate supply is fairly inelastic in the short-run.

did begin it might be controlled by the amount of credit and the reduction in the period of the loans. Short-term legislative measures could help in achieving this.

II. Long-Term Reform

The main aim at present is to design and construct an effective income tax, other than the present one, to achieve the following objectives: (a) a higher degree of equity in the tax system where indirect taxation with its regressive character predominates; (b) raising ample revenue for capital formation through the public sector; (c) income tax should not hamper production but encourage private saving and investment; and (d) maintain economic stability.

The needed reform has accordingly to be directed towards:

(i) a more personalised and flexible income taxation; and

(ii) the establishing of a more efficient administration.

To reach these major targets we believe that the reform should be the change and shift towards a unified, or one-fold income tax system instead of the two-fold present system.[1]

A Pathway to a "Unique" Income Tax System

A. Framework of the Reform:

The defects of the existing income tax system have been increasing in spite of the innumberable amendments and patching up of the legislation

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1) The proposed reform should be studied carefully and then legislation could be enacted. These steps have to be taken in the transitional period. The administration has to be prepared to carry out immediately the application of the new reform, in order to avoid any time lag such as actually occurred when the present income tax was introduced in 1939. The actual functioning of the tax administrative machinery only began about two years later, and this retarded the full enforcement of the tax for almost two years. We have to bear this unfortunate experience in mind before enforcing the new reform.

and changing the administrative tools. A complete change in the structure of this tax is therefore necessary. Egypt has gained valuable experience during the last two decades from the imposition of the income tax: trained officials; equalization, to a certain extent of the distribution of the tax burden; tax consciousness, although limited; and other legal and accounting discipline which spread among taxpayers as well as lawyers and accountants.

The change is based on the introduction of a one-fold income tax,[1] having in mind the United Kingdom, the U.S.A., the Canadian, and the French systems.[2] We are not going to import one of the above systems, but a careful study of each has to take place before adopting any of their features. We should not forget the unfortunate experience which resulted from the wholesale adoption of the French system (before 1948 reform) in 1939. This mishap should not be repeated as the country is in great need of stability in the fiscal structure, and flexibility of the revenue on the other hand.

Two fundamental factors have to be considered carefully when introducing the new tax reform:

(a) the rationalization of the tax base, which includes the conflict between equity *versus* revenue yielding, and

(b) maximization of the "overall flexibility" as well as the "built-in-flexibility" of the new tax.

These two targets could be achieved basically through the medium of exemptions and reliefs as well as the definition of taxable income.

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1) In our discussion I refer to the United Kingdom and the U.S.A. income taxes as a one-fold system. I consider what is called the Surtax or the Super-tax as only a change in the tax rate and not as a separate tax.

2) The French system after the reform of December 1948.

Before discussing these two factors it seems desirable to give the basic outline of the proposed system, without indulging in details, as details need careful study after agreement has been reached on the principles.

The proposed tax contains two fundamental sections, (i) a personal income tax; and (ii) a corporation income tax.

The personal income tax is levied on all individual taxpayers on their total income from various sources at a progressive rate applicable after the deduction of personal reliefs. The differentiation of the proposed system between personal and corporate incomes does not imply that the tax is not of a "unique", i.e. unified appearance. It is only a differentiation necessary to introduce into the new income tax an element of personalization of personal income as against income realized through non-individualistic organizations.

1. The Rationalization of the Tax Base

Any wise and foresighted fiscal policy requires selecting the best possible combination of revenue measures rather than relying upon any one measure alone. In its basic design the combination has to provide for (a) a means of mass taxation which would raise large amounts from the population without imposing an excessive burden on particular groups, i.e. an equitable tax system; (b) a more exclusive tax applying to the well-to-do groups of the population without hampering their propensity to save; (c) one or more taxes designed to check and taper windfall incomes arising out of fluctuations in prices and speculation in non-productive assets; and (d) special tax provisions for regulatory objectives.

Income taxation in almost all underdeveloped countries, where the agricultural and non-monetary economy predominates is of limited application. This is due to low income per capita, usually below the subsistence level or just around it. The income tax base, or, more comprehensively, the tax field of operation is very narrow in these countries. This fact does emphasise that the public sector cannot depend on income taxation alone for capital formation.

From our previous analysis (Chapters III and IV) we have seen that the majority of the Egyptian population, about 78 per cent are engaged in the agricultural sector where income is below what could be recognised as the subsistence level. Generally speaking the number of taxpayers subject to the present system is very small and we have to take this fact into consideration when reforming the income tax system.

To raise a sizeable amount of revenue through income taxation in Egypt as is in the case in most less-developed countries, we find ourselves faced with the problem of equity. As the equity maxim is of primary importance in taxation more emphasis has to be put on this concept in formulating the new income tax in order to lessen the regressive burden created by the indirect taxes. If we include individuals below the subsistence level, without giving in return, direct or indirect social benefits on a compensating level, a severe violation of equity occurs. Moreover, loss of revenue might occur due to uneconomical collection of the tax on low-income groups. Also, we should not forget the socio-political implications in this case. By and large, in planning the size of the tax base, income needed for more subsistence necessities such as food and shelter should be excluded.

The second, but more important, item to consider is the definition of taxable income within the scope of the personal income tax. A clear definition of taxable incomes has to be provided in order not to exempt any type of income which the planner intended to tax. Definitions of "origin", "domicile", "residence" .... etc., have also to be clearly defined in order to facilitate the application of the tax and prevent any unjustifiable exemptions or over-taxation of incomes or taxpayers. Agricultural profits have to become taxable after even if their inclusion might arouse some administrative difficulties. Generally, the new income tax should be imposed on all sources of income on an accrual basis and not otherwise, such as is the case in the taxation of non-commercial self-employed professionals under the present system.[1]

Capital gains taxation must be studied on its economic effects and from the viewpoint of equity as well as administrative feasibility. As previously mentioned (Chapter IV) a capital gains tax could be established for regulatory objectives and not as a revenue yielder.[2] The main object of the tax, however, is to eliminate, if not to prevent, investment in non-productive assets, and to tap away a sizeable part of windfall gains which usually originate in the first period of development. We have to consider very carefully the disincentive effect of the taxation of capital gains on saving and investment. For avoiding any disincentive effects in this case, it seems appropriate to exempt profits from speculation in the stock exchange. Non-fiscal measures, on the other hand, could be introduced to eliminate any abnormal and harmful fluctuations in the stock exchange markets and thus avoid the rigidity of fiscal measures and their disincentive effects.

After identifying clearly incomes to be included in the tax base we reach the stage where the personalization of the tax (the personal income tax), as one of the main objectives of the reform, has to be achieved. This objective

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1) See Chapter IV on this topic from the equity viewpoint.

2) See arguments on the taxation of capital gains in general and in Egypt in particular, Chapter IV.

could be attained through the introduction of a series of personal reliefs which take the personal circumstances of the taxpayers into account. Allowance for all expenses necessary for the creation of income has to be provided while double deduction of some items should be prevented.

The following are considered the most important personal reliefs which have to be introduced in order to maximize the personal element of the personal income tax and achieve a more equitable distribution of the tax burden than the present system:

(i) The provision of earned income relief to differentiate between earned and unearned incomes. We would take as a model the British system; i.e. the regressive percentage on earned income. This differentiation will inc ease the progression of the tax rate.[1]

(ii) Life and health insurance; pensions should be deductible, yet a limit has to be provided for the insure amounts in order to prevent tax evasion.

(iii) All payments for social security schemes and old age pensions have to be deductible from taxable income. Amounts deductible have to be fixed in relation to the capacity to pay; in other words according to the person's earnings and his family status. A maximum has to be provided, however, in order to avoid tax avoidance and hence inequity.

(iv) Personal allowances; an exception limit for a single person (a personal allowance) should be available to each taxpayer resident in Egypt. Other personal allowances have to be made available in respect of the wife and for each child. We recommend a single proportional allowance subject to

1)See arguments on this topic in Chapter VI.

a maximum and minimum; for example, this allowance could be £E50 where the income does not exceed £E500, and 7 per cent of income for incomes between £E500 and £E700.[1] On the other hand a limit for the number of children for whom the person benefits from this allowance has to be provided. The limit in this case serves as a deterrent to the increase in population, which is one of the fundamental problems in less-developed countries. By and large no income tax system can provide a list of all personal allowances covering all personal circumstances. Therefore, we find ourselves directed towards the adoption of few but clearly identifiable allowances covering a substantial number of cases. Equity is better achieved in this case than having a system of personal allowances including innumerable types of cases which render its administration with reasonable certainty and accuracy extremely difficult. Finally, the main aim of personal allowances and reliefs is to provide for a more equitable distribution of the fiscal burden especially on those who are in low and middle income groups. On the other hand, these reliefs would serve as an effective tool in increasing the graduation of the tax rate. On the whole the tax burden would be adjusted not only by variations of the rate but also by the grant of allowances in respect of certain categories of personal circumstances that affect the taxpaying capacity of the individual taxpayer, and a differentiation between earned income and investment income.

Now we turn to business profits either realized through a private enterprise or a corporation; the latter is subject to the corporation tax rate. The computation of business profits has to follow closely accounting principles with few exceptions concerning specific allowances; such as depreciation, depletion and others, which have to be considered on an economic

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1) We have been guided by proposals set up by the Royal Commission on the Taxation of Profits and Income, Second Report, pp. 55-58 April, 1954, Cmd. 9105.

as well as a technical basis. Economic basis does include considerations regarding the effect of the size of the allowance and the different ways of its computation, on economic growth.[1] Its effect on tax revenue, on the other hand, is anticipated.

2. Maximizing the Tax Flexibility

The tax flexibility is normally created through; (a) the flexibility of the tax rate; a progressive tax is more flexible than a proportional one; (b) the ability to change the size of the tax based by increasing or decreasing the exemption limit and other personal reliefs.

The tax rate is of great significance as it affects the yield and the redistribution of personal income. Reliefs on the other hand increase the graduation of the rate scale and hence promote the overall progression of the income tax. The rate should be progressive, but not steep to the extent that it would become a disincentive factor to private savings and also to work. A test of the progressiveness of the marginal rate is important in our case in order to prevent evasion and the adverse effect of the tax on incentives. Yet the Government public policy guides the structure of the rate and in this context it usually faces the conflict between equity and revenue.[2] Generally speaking the main core in constructing the tax rate during the economic development period is to increase the rate, in relative terms, on income brackets where the majority of taxpayers come from. In Egypt most of the income taxpayers come from middle and higher income brackets and to increase the rate, in relative terms, would result in inequity. This could be remedied by the aid of the various personal reliefs. On the other hand we do not recommend at all very steeply progressive rates on high income brackets because

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1) Incentives for economic development through income tax measures within the framework of the proposed system are stated later.

2) It is well known that governments could control the fixation of the tax rates but not the yield, and therefore equity considerations seem more important, as the increase in the yield due to the increase in the rate is probably not high enough to sacrifice equity.

such steepness, as previously mentioned, would reduce considerably the propensity to save of the class where the large proportion of private savings originate.

The tax rate on corporation profits is a two-fold flat rate; a reduced rate on profits below a certain level say £E10,000 and a higher rate on profits above that level. The differentiation would help small and closely held corporations with small capital to be established, as it is highly beneficial for economic development to encourage private investment in corporations where capital plays a secondary role compared to other factors of production; e.g. labour intensive rather than capital intensive ventures.

Two basic consideration have to be borne in mind; (a) the avoidance of the double taxation of distributed profits, and (b) to reduce the tax rate on undistributed profits to encourage the ploughing back of profits and hence increase private investment.[1]

In general we have to assume a high rate of built-in-flexibility of the new tax in order to meet the inflationary tendencies which usually accompany the first phases of development.

Consequently, to render the tax more effective and more responsive to economic fluctuations and to revenue needs, the tax rate, personal and corporate, has to be fixed annually by the Treasury when preparing the budget. Similar action could be applied in the case of personal reliefs which, as we know, affect the progressiveness of the tax rate.

B. The Administrative Issue

The relative simplicity of the single-tier income tax compared to the

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1) This incentive is discussed in Chapter VI in detail and we shall refer to it later in this Chapter when considering the economic effects of the reform.

present two-tier system is the basic advantage of our proposed reform. As we have pointed out in various parts of this work, administrative efficiency of the tax is very important. Such importance lies in the fact that a tax backed with an efficient administration although inequitable, is better than an equitable tax with a corrupted and inefficient administration.

Maladministration opens the door for evasion, loss of revenue and inequity.

Under the new income tax the individual will submit one main comprehensive return instead of the several returns he submits under the present system if he has income from different sources; e.g. dividends, salary, business profits etc. One system of personal reliefs and exemptions is applicable to the taxpayer instead of a diversified and unco-ordinated system of personal reliefs.

Assessment and collection will also be simplified. One tax inspector will be in charge of the tax assessment of the individual, while under the present system we find that two or more tax officials assess the income tax on one taxpayer as he may be liable to more than one schedule tax. Appeal to internal Commissioners and to Courts of Justice will be simplified too. By and large, the administrative burden of the proposed tax would be considerably less than the burden of the present system.[1]

To ensure an efficient income tax the Treasury has to undertake the

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1) See a translated English version of a report submitted by the writer to the Egyptian Taxation Department in April 1954 after spending a year in the U.S.A. and Canada, where he attended the International Programme in Taxation at Harvard University and studied the application of both U.S. and Canadian income tax systems at respective Government Departments, under a grant from the United Nations Technical Assistance Programme. This report proposes a single-tier income tax to replace the existing system. The administrative organisation of the new proposed tax is drafted in detail in this report.

training of personnel in order to prepare them for the proper enforcement of the new system. On the other side, a wide scale campaign through radio, lectures and other means of spreading information regarding the proposed tax is necessary to increase the taxpayers' fiscal morality and tax conscience.

Incentives for early payment of the tax; i.e. paying the tax of the current year in instalments instead of waiting until the end of the year, could be considered. Such incentives could take the form of a percentage deduction from the tax paid in advance. This type of incentive has a dual advantage to both the Treasury and the taxpayer; accessible revenue to the former and percentage reduction of the tax debt to the latter.

C. Economic Effects of the Reform; Public Policy Issue:

The public policy issue of the proposed tax implies the discussion of its effect on the following: (a) capital formation through its impact on incentives to save and invest, (b) stabilization of the economy, especially during the phase of development, and (c) the redistribution of the fiscal burden.[1]

(1) Capital Formation:

As previously mentioned, income taxation within a less-developed country like Egypt does not supply the sizeable amounts of revenue needed for capital formation, for many reasons. The most important reason is the low income per capita. Therefore, the Government has to rely on other sources of revenue to supply the public sector with adequate amounts for capital formation. Fiscal and non-fiscal measures could help in attaining this objective. Encouragement of private savings through fiscal policy is an

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1) The discussion of these criteria will be very concise as the main object is to explain the basic fiscal policy objectives and the effect of the tax on them. The discussion is merely a guide to policy makers.

important factor which has to be considered when framing our fiscal and monetary policies.

In general the major theoretical considerations guiding a tax policy towards investment and initiative in the public sector are:

(i) A developmental policy has to be integrated with monetary policy which closely affects the capital and money markets, price and wage levels, consumption etc.

(ii) The tax policy should appear to be permanent but must at the same time be flexible so as to respond to changes as they arise.

(iii) Multiplicity in taxes, i.e. unnecessary subsidising, "nuisance" taxes should be avoided. Examples of such taxes in Egypt are, the Defence Tax, the Surtax on the Schedule Income Tax for the benefit of Municipalities and Local Authorities,[1] the tax on Corporations' Directors and so on.

A high degree of multiplicity in taxation of a haphazard nature is not in the long run in the interests of the economy especially where the tax is direct and noticed by the taxpayer.

These are the main criteria of a tax policy directed towards capital formation. But what are the basic incentives which we should provide in the proposed reform to stimulate investment? These incentives could be summed up in the following:

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1) The tax revenue in this case is collected by the Taxation Department for the Ministry of Municipalities and thereafter distributed among the various municipalities according to their requirements.

(a) Granting accelerated depreciation relief to new enterprise recognised as necessary to economic development.[1*] (A committee composed of experts, financial and technical, should be responsible for decisions concerning the importance of the new enterprise to the economy.)

(b) Uncertainties involved in investment have to be reduced. This could be achieved through liberalising the "carry-forward" of business losses indefinitely.[2]

(c) Applying a reduced rate on undistributed corporate profits to encourage their reinvestment. The differentiation in fiscal treatment between dividends and business savings in underdeveloped countries is based on the fact that the capability of individuals to invest their dividends in productive assets is very limited. Most of such dividends are usually spent on conspicuous consumption, hoarded or invested in unproductive assets such as land. By and large, as corporations enjoy a more efficient entrepreneurship than the individual. The application of the reduced rate has to be limited in two ways; first, in time, in order to avoid evasion through increases in the value of equity capital and then realising untaxed capital gains; and secondly, to the type of enterprise which is important to economic development.

(d) Agreements for the avoidance of double taxation and evasion could help greatly in encouraging foreign private investment. Their conclusion should be limited only to capital exporting countries.[3]

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1)* See arguments for and against accelerated depreciation and conflicts which arise between incentive to invest and loss of revenue, in Chapter VI.

2) See Chapter VI for detailed analysis of business losses reliefs.

3) See Chapter VII especially the section on International Double Taxation.

(e) In regard to the encouragement of private savings, the personal income tax should exempt interest paid on savings accounts deposited with the Post Office Savings Banks and other banking institutions. This would encourage the middle income groups and even individuals below that class to save. Non-fiscal measures could be applied too; e.g. money prizes given to individuals who save above a certain level, etc.

(2) Stabilization of the Economy:

Income taxation in less-developed countries has been critisized as not being effective in stabilizing the economy. This is mainly due to the limited scope of its application, i.e. small numbers of people subject to tax. Therefore, we have to find another fiscal device as an alternative. Indirect taxation has been devised to stabilize the economy, especially when the inflationary trend spreads during the execution of development programmes.[1]

Taxes on consumption, e.g. purchase tax, excise, etc. are more effective in curbing inflation resultingfrom increases in purchasing power over the domestic output within the first phase of development. The imposition of such taxes would raise the problem of equity, as indirect taxes are considered regressive. But we could impose purchase tax, for example, on a progressive rate with the exemption of food stuffs and other necessities, e.g. clothes consumed by the poor class. Another argument could arise, that is the imposition of a sales tax which would result in an increase in the cost of living indices which would result in an increase in wages, and this might intensify the inflationary pressure. This

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1) Sales taxes are considered more feasible than income taxes from the administrative side and thus more effective; especially excise and import duties.

argument can be refuted as although most of the working class in a less-developed country like Egypt do spend their wages on mere necessities, especially on food, these are exempted from the indirect tax. Most of the increase in the wage sector of the national income would be directed towards increasing the consumption of necessities which the wage earner could not buy before. This is because their previous wages were much below the subsistence level, as most of the new working power would come from the abundant labourer supply of the agricultural sector where there is a lot of disguised unemployment.

Consequently, stabilization, without which economic development is difficult, needs an instrument more flexible and quicker than fiscal policy to handle it, and monetary policy, being more flexible can act and manipulate it more quickly. Thus, there should be a close integration and partnership between fiscal policy and monetary policy to achieve a high degree of economic stability within the developing economy.[1] Non-fiscal measures, other than monetary policy, could be applied, such as rationing of specific commodities, but there is great doubt concerning its feasibility with an uneducated majority.

However, the above factors do not destroy the ability of the proposed income tax to help in stabilizing the economy. The exemption limit and other personal reliefs as well as the tax rate could be easily adjusted to combat the instability in the economy. Within the business sector, the

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1)* The co-ordination implies two things: (a) a day-to-day understanding between the Treasury and the Central Bank of Egypt on equal partners; and (b) the readiness of the tax policy maker to analyse experience, minimize errors and learn lessons from current mistakes to help him in future planning.

corporate tax could be conveniently used for controlling economic fluctuations through the different allowances, such as the depreciation allowance, loss carry backward or forward, and also the rate structure differentiating against or in favour of corporate savings. But, on the whole, as we mentioned, the over-all impact of any income tax measure is limited and has to be supplemented by other measures fiscale and non-fiscal, to accomplish a stabilized economy.

3. Redistribution of the Fiscal Burden; Equity Aspect:

In backward economies development has been retarded because of low savings. The need in an underdeveloped country is for a revenue-producing, investment generating tax policy. Such countries, therefore, depend on indirect taxation as a main source of tax revenue. Hence, equity considerations, in many cases, are disregarded, as indirect taxes with their regressive character, increase inequity in the distribution of the tax burden. The new proposed income tax, however, would help considerably to attain a more equitable distribution of the public burden, as the main aim of the reform is to introduce a more personalized tax.

On the whole income taxation should be looked at during the first stages of development as the basic tax which brings equity to the tax system. It could, therefore, be considered as the safety valve of equity in the tax system.

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